WTO, agriculture, and developing countries. The case of Ethiopia

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Foreword

The 3rd Ministerial Conference of the World Trade Organization (WTO) at Seattle was not able to launch a new and comprehensive round of multilateral trade negotiations, but it is expected that in the coming years the WTO will be the forum of these negotiations, commonly referred to as the Millennium Round. Developing countries are currently greatly involved in the WTO process and seek active participation in this round.

The Food and Agriculture Organization of the United Nations (FAO) has for several years assisted the developing countries in assessing the consequences of the previous Uruguay Round Agreements on their agricultural sector and in preparing for the new round of trade negotiations. The FAO has also supported research in this area, and in 1995 it commissioned the Centre for World Food Studies (SOW-VU) to conduct, in cooperation with experts from Ethiopia and with the Ethiopian government, a study on the possible impact of the Uruguay Round Agreements on food and agriculture in developing countries, with special reference to Ethiopia. The project (GCP/ETH/053/NET) was entitled 'Adapting Food and Agricultural Policies to a Changing External Trade Environment.' Focusing on the trade flows of six commodities that are of special relevance to Ethiopia, the study assessed the consequences of the WTO rules on domestic policies with respect to food and agriculture, and identified a set of policy measures that would enable Ethiopia to make better use of the new trading environment. Ethiopia is not a WTO Member as yet, but the analyses reported in the paper remain valid if Ethiopia were a WTO Member.

In spring 1999, the Centre was requested by FAO to undertake a follow up study, reviewing unfinished business of the previous Uruguay Round as well as new issues, both in relation to least developed countries in Africa, and with Ethiopia as country for a case study, while incorporating the main findings of the earlier study. This is the subject of the present paper.

The paper argues that the Agreement on Agriculture, part of the Uruguay Round Agreements, has put a system of basic mechanisms into place but not led to significant agricultural trade liberalization. Developing countries were not affected much either, as the rules applying to them were less stringent and contained many exemptions for least developed countries. They currently seek continuation of their special and differential treatment, but more importantly would like to see the new round focus on development by paying due attention to their specific constraints for being competitive rather than on trade liberalization itself. At the same time, a host of new issues have emerged since 1994 that relate directly or indirectly to food and agriculture. First, regional trade agreements such as NAFTA and Mercosur can interfere with the multilateral negotiations, and the same holds for the regional trade agreements through which the EU intends to continue its preferential arrangements with ACP countries. Second, new non-tariff barriers for developing countries might result from consumer concerns about product safety and quality, or about modes of production such as labor standards and environmental sustainability. Finally, knowledge related goods (pharmaceuticals, seeds, software) pose new challenges, to balance the protection of intellectual property rights for producers with basic needs of consumers in developing countries. The report highlights the various interactions between these subjects from the perspective of Ethiopia.

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List of Acronyms

ACP	African, Caribbean and Pacific
AMS	Aggregate Measurement of Support
APEC	Asia Pacific Economic Cooperation
BSE	Bovine Spongiform Encephalopathy (Mad Cow Disease)
CAP	Common Agricultural Policy
CEEC	Central and Eastern European Country
CIP	Coffee Improvement Project
COMESA	Common Market for Eastern and Southern Africa
DSU	Dispute Settlement Understanding
ECU	European Currency Unit
EFTA	European Free Trade Association
EU	European Union
FAO	Food and Agriculture Organization
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
IPR	Intellectual Property Right
IMF	International Monetary Fund
LDC	Least Developed Country
MFN	Most Favored Nation
NTB	Non Tariff Barrier
NAFTA	North American Free Trade Agreement
OECD	Organization of Economic Cooperation and Development
PTA	Preferential Trade Agreement
REPA	Regional Economic Partnership Agreement
R&D	Research and Development
SITC	Standard Industrial Trade Classification
SSA	Sub-Saharan Africa
SSG	Special Safeguard Guarantee
TRIM	Trade Related Investment Measures
TRIPS	Trade Related Aspects of Intellectual Property Rights
TRQ	Tariff-rate Quota
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UR	Uruguay Round
WFP	World Food Programme
WTO	World Trade Organization

EXECUTIVE SUMMARY

1. Despite current difficulties in reaching agreement on an agenda the World Trade Organization (WTO) intends to start a new round of multilateral trade negotiations known as the Millennium Round, which is scheduled to include trade in agricultural commodities and services, and will possibly be broadened to cover other topics such as consumer concerns and intellectual property rights. Both topics are of major concern to developing countries, since they define the access to markets for exports and the access to knowledge.

2. The Uruguay Round Agreements for the first time included trade in agricultural commodities. As many developing countries derive most of their export earnings from trade in agricultural commodities, the GATT/WTO agenda is of great importance to them.

3. The present report reviews the present status of implementation of the Uruguay Round Agreements, the issues pending as well as new issues with special reference to least developed countries (LDCs) in Africa, with Ethiopia as a case study.

Present status of Uruguay Round Agreements

4. The Uruguay Round Agreements specify that developing countries, and the LDCs in particular, will continue to receive Special and Differential Treatment, consisting mainly of relaxations of the reduction requirements for import tariffs, export subsidies and agricultural support. A developing country can implement the specified reductions over a longer period. The reduction requirements are also weaker and include exemptions for items such as public investments for development and agricultural input subsidies.

5. On agriculture, the Uruguay Round Agreements stipulate that all forms of import barriers are to be converted to fixed tariffs. As major exception to this rule, minimum access quota should be granted at low tariffs, according to country specific schedules of commitments. Tariff ceilings are to be reduced gradually over time, but the LDCs are exempted from this obligation, while most developing countries do not need to reduce them, since this is the first time they bound their tariffs. The agreement also specifies how to measure aggregate support to agriculture (AMS), which is not allowed to rise for the LDCs and to be reduced for the other countries. Similar reduction rules hold for subsidized exports.

6. The general reduction of tariffs causes the value of trade preferences of developing countries to diminish, and implies a loss for several developing countries in Africa. Despite pledges to consider carefully the negative effects of Uruguay Round Agreements for LDCs, no explicit financial compensation mechanism has been worked out.

7. The period 1995-1999 during which Uruguay Round Agreements have been implemented, did on average not show the improvement of the international prices of agricultural commodities in real terms that had been anticipated. Confounding factors may have been the crises in Asia and Russia as well as climatic variability, but another reason might be that the agreement led to little

effective improvement in import access. Its major contribution is to have put the mechanism of future agricultural trade liberalization in place.

8. The Dispute Settlement Undertaking (DSU) of the Uruguay Round Agreements offers all WTO members an easy access to a unified procedure that covers all multilateral agreements. Developing countries have increasingly invoked the procedure, and were relatively successful, even in cases against developed countries.

Ethiopia and WTO

9. In Ethiopia agriculture is, like in many other LDCs, the major economic sector in terms of value added, employment and exports. Coffee, hides and skins are the main export goods. Population is growing fast and the scope for expansion of the cultivated area is limited, but there is significant room for yield improvement.

10. Since the change in government in 1991, Ethiopia has implemented a variety of structural reforms under the guidance of the International Monetary Fund and the World Bank, whose conditionalities with respect to trade liberalization appear to be stricter than those of the WTO. The domestic economy has been liberalized, import tariffs have been reduced, export subsidies abolished and privatization of state owned enterprises has started.

11. When corrected for purchasing power parity, GDP growth reached 6.1 per cent over the period 1992-’96 but in view of successive devaluations of the Birr, no growth could be recorded in US dollar terms.

12. Ethiopia currently only participates in the WTO as an observer. WTO rules would impose few restrictions on current economic policies due to the many exemptions applicable for LDCs and to Ethiopia’s policy reforms since 1991. The current development projects for coffee, cereals and livestock are fully exempted from the reduction requirements. For its processed products, Ethiopia is allowed to maintain the export subsidies incorporated in the prevailing duty drawback scheme, until the country becomes competitive on the world markets for the commodities concerned, which might soon become the case for processed skins of sheep and goats.

13. Present WTO rules imply that Ethiopia’s initial AMS is very low, which limits the scope for introducing agricultural support policies such as floor prices. To maintain maximal room for its domestic policies, Ethiopia could consider notifying its AMS, as any other nominal amount in its schedule of notification, in euros rather than in domestic currency. Policies to stabilize the domestic food prices are also restricted by WTO rules on import tariffs, though present agricultural imports largely consist of food aid, that are exempted from tariff restrictions.

14. Ethiopian representatives emphasize that the alleviation of supply constraints remains the main concern of the Ethiopian government. In this perspective, development assistance and the strengthening of the special and differential treatment play a central role. And yet, it is also in their interests that unfinished business and new issues be attended to during the next round.

Unfinished business

15. Ethiopia is, like many other LDCs, asking for continuation of the Special and Differential Treatment under a new WTO trade agreement.

16. African LDCs would generally benefit from improved access to the markets of developed countries, particularly to the EU whose present Common Agricultural Policy (CAP) imposes severe restrictions. Ethiopia would gain from increased opportunities to export fruits, vegetables and possibly sugar. Although its livestock potential is large, it will prove difficult to improve the quality of meat and dairy products and it seems almost impossible to raise it to a level that can meet the strict sanitary standards of many importing countries overseas.

17. Multi-functionality may be a promising approach to articulate Green Box policies. It allows the EU and other OECD countries to acquire sufficient political backing domestically for agricultural policy reforms that increase foreign access to their markets. Under this approach, farmers receive payment for the environmental and other services they provide, preferably directly from the consumer, but possibly through local taxes (e.g. a tourist tax). If sufficient revenue can be mobilized in this way, it becomes possible to eliminate all price support, and to increase import access without undermining the viability of the European countryside as subsidies could be limited to general developmental efforts in less favored regions.

18. Within the CAP, sugar has so far escaped any reform. For this sector, elimination of all import protection would virtually mean eradication, mainly because the sugar factories, rather than the farmer, would face foreclosure. A reform that would leave a significant part of the sector in operation is likely to gain more support. Such a reform might include reduction of production quotas, which could eventually create some room for expanding imports from developing countries, either on preferential terms, or with an import tariff whose proceeds could be earmarked for development assistance.

19. LDCs would also benefit if (some) WTO members instituted the legal changes that would make WTO regulations admissible in ordinary courts. Currently, traders have to convince their own government of the need to file a complaint, which they may find difficult. Moreover, if many of them are successful, the large number of complaints will soon overburden the WTO. Furthermore, making WTO regulations admissible in civil courts also allows to impose serious sanctions, and to maintain, through jurisprudence, sufficient dynamism in the interpretation of earlier agreements.

New issues

20. While multilateral trade liberalization is the professed consensus at the start of the Millennium Round, new regional agreements abound which in many respects contradict this view. The EU for example intends to organize its development cooperation through treaties with specified regional groupings (REPAs) and to grant trade preferences to these groupings. The approach is controversial because of the trade diversion and new protection it can generate. Some call it a stepping stone, others a stumbling block to further trade liberalization. Like other developing countries Ethiopia mainly objects that the regional groupings should emerge spontaneously on the basis of cooperation between neighbors, rather than because donors want to reorganize their framework of cooperation.

21. Consumer concerns prevailing in developed countries lead to product differentiation and vertical integration along the food chains, from field to table. These concerns pertain to characteristics of the food product itself such as safety or taste, as well as to moral aspects of the technology (labor standards, animal welfare, and environmental sustainability). They offer developing countries new opportunities to supply higher priced qualities, such as organic food, but also impose severe requirements on product grading and labeling. These might be too cumbersome for developing countries to implement, and could thus develop into new non-tariff barriers, much like the current phyto-sanitary standards. Then, developing countries could become mere producers of raw materials, relegated to the bottom end of the chain where they can only supply low priced bulk products, while processors and retailers earn the rent from product differentiation. Hence, it is important for developing countries to acquire sufficient control over the chains in which they operate, possibly through joint ventures. The WTO could contribute by imposing some order in the issue of labeling, by promoting standards, and by avoiding unfair assignment of the burden of proof when satisfaction of a standard is being challenged.

22. Production processes become increasingly dependent on knowledge creation. In agriculture, seed development is a case in point. LDCs have to choose between low yielding traditional varieties that can multiply, and high yielding varieties that cannot and whose seeds have to be purchased from a handful of multinational companies. The same holds for pesticides and for the pharmaceuticals in livestock production. For the WTO, this problem creates a dual task. The first is to ensure that Intellectual Property Rights (IPRs) are being protected. This is also in the interest of developing countries because it will promote the orientation of research to their needs. The second is to see to it that respect of IPRs, and more generally the elimination of tariffs, does not create new monopolies and monopolistic rents, in short, to develop an effective international equivalent of national competition policies.

Chapter 1

Introduction

In Seattle, between 30th November and 3rd December 1999, the World Trade Organization (WTO) organized a ministerial conference marked to establish the agenda of the Millennium[1] Round, a new round of international trade negotiations. The Millennium Round is the successor of the Uruguay Round which resulted in the Uruguay Round Agreements and the establishment of the WTO, and extended to the agricultural and services sectors. It might seem that with the establishment of the WTO as a permanent institution the need for further multilateral rounds has diminished, as member countries can now meet regularly to discuss upcoming issues, to set up specialized committees on contentious subjects and to reach compromises. Moreover, as the 1994 agreement laid down the basic rules for trade liberalization, one could expect that all attention can be devoted to the effective implementation of the reduction of bound tariffs as pledged by the participants and the dispute settlement procedure of arbitrage by independent panels. Nonetheless, it became already clear during the 1996 ministerial conference in Singapore that a new multilateral round was required because the internal process would be incapable of generating sufficient momentum to resolve outstanding issues and to table new ones. Hence, it was decided to start a new round that should deal with trade in agricultural commodities and services, and possibly be broadened to cover other topics to be decided upon at the Seattle conference. But no agreement could be reached on the agenda of the round.

The official conference was preceded by a symposium to encourage an informal dialogue with the NGOs. Over ten thousand representatives of NGOs, trade unions and action groups came to Seattle for the occasion, signaling that the WTO round has become a major international forum for economic consultations. But the mood was not always friendly. For many NGOs, the WTO has almost become synonym to globalization, and all forces opposed to multinational capitalism as epitomized by McDonald’s and Monsanto joined in an attempt to stop the multilateral process of trade liberalization. Preservation of local identity is their common denominator and includes safeguard of historical heritage as well as ecological diversity. Specifically, the opponents fear a global monoculture and reject WTO’s endeavors to promote international comparability and standardization of products, which promotes international competition and rewards the winners but neglects the contribution of the losers. Some critics claim that WTO induced liberalization tends to promote monopoly, with tariffs replaced by new rents hidden in patents, brands and hermetically closed production chains. Others point out that in developing countries and economies in transition the process of trade liberalization and deregulation has only led to contraction because its causes disruption of existing production chains, as inputs suppliers and agricultural processors went bankrupt. Finally, specialized NGOs express concerns with respect to the environment, animal welfare and labor standards and ask for the relevant externalities to be internalized in some way through taxes, quantity constraints, or tradable property rights.

Clearly, theoreticians were not represented in Seattle but they have been concerned with trade liberalization as well and prepared the ground for much of the current debate. Interestingly, perfect competition only plays a modest role in the modern theory of international trade and imperfect competition takes a far more prominent position. This literature suggests that trade

[1] Although no official name has been agreed upon to date for the new round of trade negotiations, it is commonly referred to as the Millennium Round.

liberalization may lead to further concentration and that tariffs may serve to tax monopoly profits. It also highlights the inbuilt conflict between the multilateralism of the WTO process and the current trend towards regionalism. For example, the EU is preparing for accession of new members from Central and Eastern Europe and has by means of its Agenda 2000 initiated various changes, including a reform of its Common Agricultural Policy (CAP). The EU is also engaged in organizing its future development cooperation according to regional groupings (REPAs) with whom it seeks to conclude agreements on aid and trade. Similarly, Mercosur, NAFTA and APEC have been strengthening their position.

Governments react selectively to the various issues and currently take very different positions. The USA called for elimination of export subsidies by the EU and Japan, and opposed the labeling requirements on food imposed by imports on genetically modified organisms in food by these countries. Other agricultural exporters also asked for elimination of export subsidies. The USA proposed to place the issue of labor standards on the agenda. The EU and Japan took a different position and asked on their part for a review of the anti-dumping practices, a faster liberalization of trade in textiles, a demand supported by many developing countries. In addition, several countries tried to table environmental issues and insisted that the various environmental and recreational services rendered by agriculture should be rewarded separately (multi-functionality). Regarding services, East Asian governments insist on mitigating speculative flows of international capital in the future and want to keep the domestic banking sector under tight government control. Developing countries generally want to reopen the discussions on many matters that were settled during the Uruguay Round, such as an elaboration of their Special and Differential treatment and the agreement on intellectual property rights. OECD countries on their part would like to proceed further on these subjects but after taking note of the position of developing countries, they became more hesitant. Therefore, it was hardly a surprise when it proved impossible to agree on the agenda at the end of the three-day conference in Seattle. The WTO continues to function as an organization and the agenda is being prepared through diplomatic channels. Indeed it appears that to avoid protracted negotiations during the round, participants have decided to “frontload” all difficulties within the discussion on the agenda, which thus became a vital part of the negotiating process itself. But the disagreement in Seattle clearly illustrates that this approach may be very ambitious.

At a more abstract level, one may notice that the Millennium Round sees itself confronted with a wide range of reasonably well defined issues, summarized by keywords such as food safety, intellectual property rights, international competition, access to courts, or environmental sustainability. Every issue has its own stakeholders in civil society world wide but most were formulated in the North. Consequently, developing countries often find it difficult to assess the scope and strength of the various concepts and to decide which coalition to join.

The aim of the present paper is to review these issues and concepts against the background of the current implementation of the Uruguay Round Agreements and to consider their current implications for developing countries. Special reference will be made to the Agreement on Agriculture as viewed from the perspective of a least developed country (LDC) in Africa, with Ethiopia as a case study. Like in most other LDCs, agriculture is Ethiopia’s major sector and the formal sector is small. Land resources are scarce, population is growing fast, malnutrition is widespread, and the country has a history of receiving considerable amounts of food aid. Export revenues depend heavily on few, generally agricultural, commodities. Less typical for an African LDC is that its mining sector is insignificant, and that tropical diseases such as malaria are less prevalent due to the cooler climate of the highlands. Ethiopia also has more than its share of dramatic events. After a civil war that only ended in 1992, a war started with Eritrea in 1999 and droughts in three successive years have now caused serious food shortages for about 8 million people.

The paper is structured as follows. Chapter 2 summarizes the Uruguay Round Agreements, with special attention to the Agreement on Agriculture, and assesses the effects on developing countries. In chapters 3 and 4 we focus on the implications for Ethiopia in terms of economic strategies in general, and selected commodities. Next, important topics for the new Millennium Round are considered. Chapter 5 discusses in general terms a possible elaboration of the special treatment as well as improvements in market access, especially to the EU, and extensions of the dispute settlement procedures. Chapter 6 reviews more recent developments, including the trend towards regionalism and the ‘new economy’ issues, which might play a role in the negotiations on agriculture. Chapter 7 evaluates the relevance of these topics for Ethiopia and other least developed countries, partly relying on views expressed by Ethiopian representatives, and concludes.

Chapter 2

The Uruguay Round Agreements

2.1 GATT/WTO: the international institution

For many years, the rules for international trade were laid down in the General Agreement on Tariffs and Trade, first signed in 1947. The treaty rests on two basic rules, the *most-favored-nation* (MFN) rule, which specifies that a concession granted to a member state must be extended to all of them, and the *national treatment* rule which forbids any preferential treatment of domestic over foreign goods after import tariffs have been paid. This is basically a non-discrimination principle that only accepts tariffs as instrument to govern trade flows. Furthermore, these tariffs should not prohibit trade altogether. The series of multilateral rounds of trade negotiations is a sustained attempt to impose these disciplines more rigorously, and for an increasing number of goods. During the first rounds, the main issue was to achieve a reduction of the rather substantial tariff rates, and for manufacturing products they were relatively successful in this respect.

The latest round, culminating in the Uruguay Round Agreements of 1994, managed to include agriculture and services into the package. It also achieved full 'tariffication' of all border measures. Through it, the proliferation of new protectionist instruments such as 'voluntary' export restraints, non-automatic licensing procedures and the arbitrary use of standards as protective measures, that enabled members to navigate through the mazes of the GATT, was stopped, in principle. However, the practical implementation proves difficult. Another innovation of the Uruguay Round Agreements was the establishment of the World Trade Organization, WTO, as the organization that governs international trade, overseeing virtually every aspect of world commerce, with a dispute settlement system to ensure adequate redress for bilateral trade problems. The Agreement establishing the WTO creates a single institutional framework encompassing both the GATT as modified by the Uruguay Round, and all other agreements and arrangements concluded during this Round. A 'single undertaking approach' is adopted, implying that membership of WTO entails full acceptance by members of all results of the Round, such as GATT 1994[2], GATS (on services) and TRIPS (on intellectual property). The WTO is considered important for developing countries because it defines their rights as well as enforcement procedures. At the same time, membership to the WTO comes with obligations: it imposes disciplines how to regulate trade and how to report on it, although during a transitional period countries have the option to apply for waivers.

The set of rules currently ascertaining the orderly conduct of trade (product definition, custom classification, setting of standards, enforcement rules, and so on) and the safeguards and exemptions is vast. There is an extensive literature on the history of the Uruguay Round as well as the economic and legal aspects of the GATT (see Staiger, 1995; Josling, Tangermann and Warley, 1996; Anderson, 1996; Jackson, 1997, Croome, 1999). Hence, our discussion[3] of the

[2] Although strictly speaking 'GATT 1994' is only one of the Uruguay Round Agreements, we refer to all the rules in these agreements as GATT or WTO rules.
[3] This chapter builds upon background report Merbis and Tims (1997).

content and scope of the WTO will be brief and focused on the Agreement on Agriculture as part of GATT 1994 and its relevance to developing countries.

2.2 The Agreement on Agriculture

The Uruguay Round was the first to treat agriculture as an integral part of world trade. From the onset agricultural exporters had disagreed strongly on the objectives of the Round, and the failure to reach a solution delayed its conclusion by some three years. Admittedly, the aim 'to establish a fair and market-oriented agricultural trading system' (GATT, 1994, p. 39) was far-reaching. In 1986, at the beginning of the Uruguay Round, *import restrictions* used to be common practice in agricultural trade, and their use had proliferated over time by way of quotas, voluntary export restrictions, minimum import price systems and the like. Several countries also used phytosanitary measures as non-tariff barriers to imports. In addition, both in developed and in developing countries a substantial part of the tariffs was not bound by any earlier multilateral agreement (i.e. had no ceiling). But market distortions were not only prevalent on the import side. Various mechanisms were in place that effectively *support producers* and *subsidize exports.*

In fact, as of fall 1999, practically all these distortions persist. The main contribution of the Agreement on Agriculture has been not so much to reduce protection as to make protection more transparent and measurable, and to ensure that it cannot increase. This was achieved through provisions pertaining to market access, domestic support, and export competition.

Market access

Improvement in market access was presumably the main advance of the Agreement on Agriculture. Instruments were requirements on tariffication, notification of upper bounds on tariffs, and, most importantly, the provision that these bounds cannot be raised in nominal terms.[4] However, in many countries, especially the developed ones, the bounds could be set sufficiently high as to remain prohibitive, and, until a new agreement rules differently, international inflation would be the only mechanism to reduce them in real terms. Developing countries were hardly involved in this part of the negotiations, which in their view were dominated by the developed part of the world. They basically took the position that developed countries were free to agree to all the disciplines they liked, as long as developing countries were not bound by them. Indeed, through the Special and Differential Treatment, developing countries can so far escape most of the disciplines of the deal (Hoekman, 1995). Let us briefly review the main elements of the agreement.

i. Tariffication: the principle of tariffication is the key element of the agreement. Parties are held to convert non-tariff barriers (NTBs) into tariffs, and the level of protection is supposed to be expressed in a tariff that is equivalent to the protection level prevailing in the base period 1986-'88. Renewing or re-introducing other barriers than tariffs is not permitted. In the past member states often invoked tariffs at their discretion, but now all member states are obliged to deliver the ceilings ('bounds') of the tariffs allowed, in their Schedule of Concessions.

[4] It is at the importer's discretion to specify the tariff as *ad valorem* or as specific duty, which can then either be in a foreign currency, for example, US dollars or euro (as in the case of Poland), or in the domestic currency. Developing countries can thus circumvent the impact of high inflation by stating their Schedules in a foreign currency.

ii. Tariff reduction: after tariffication, reduction of tariff levels should take place. Developed countries must reduce them by 36 per cent over six years, developing countries by 24 per cent over ten years. The least developed countries are exempted from any reduction. The percentage reduction is an average over all tariff lines and to avoid that reductions are only imposed on products with insignificant trade flows and high tariffs, every tariff line must be reduced by 10 per cent at least (15 per cent for developed countries).

iii. Safeguards: several provisions in the agreement must prevent that a country is flooded by cheap imports. A safety trigger measure must be applied to determine when the safeguard can be activated. The trigger measure can be expressed as a percentage of the total imports allowed, or as a minimum 1986-'88 base-period price below which imports may be charged by a levy. Safeguard duties are only allowed until the year's end and the mechanism only applies to tariffied products.

iv. Minimum access: countries must open their domestic markets at low levels of import duties up to minimum access commitments, specified as a share of the domestic market (rising from 3 to 5 per cent). These import quota face a preferential tariff up to commitments and are referred to as tariff-rate quotas (TRQs).

Furthermore, in parallel with the Agreement on Agriculture, two separate agreements were concluded that deal with technical restrictions on market access. While the Agreement on Technical Barriers covers general aspects, the Agreement on Sanitary and Phytosanitary measures (GATT 1994, pp. 69-84) addresses specific aspects of food safety and animal health. Its measures aim to limit the damage within the territory of a member from the entry and establishment of pests and to protect:
- animal or plant life or health within the territory of a member, or to halt disease and pests,
- human or animal life or plant life from risks arising from toxins, disease-carrying organisms in food, beverages and foodstuffs, and additives,
- animal or human life from the spread of animal- or plant-transported diseases or pests.

Domestic support

With respect to domestic support, the main provision of the Agreement on Agriculture has been to specify a method to bring all support under the common monetary denominator, the Aggregate Measurement of Support, AMS, classified by color, amber, blue, and green.

i. The AMS includes expenditures on domestic subsidies as well as market price support policies such as administered prices. It is calculated by summation over all commodities and programmes, but excludes instruments that have minimal effects on production and trade. Examples of such so-called 'Green Box' instruments are general support to the agricultural sector, or policies that are 'de-coupled' from production. They are summarized in Text box 1. Developing countries receive additional exemptions beyond the ones in the Green Box, e.g. for government support programmes to foster agricultural and rural development, agricultural input subsidies generally available to low-income or resource-poor farmers, investment subsidies and subsidies to eliminate illicit crops (narcotic drug crops). Developed countries also managed to exempt certain policies that were subsequently collected in the so-called Blue Box. Policies that have a production-limiting effect qualify as such. This compromise allowed the EU to legalize its hectare and headage premiums introduced in the 1992-reform which evolved as the major instrument of the CAP to support agriculture. The AMS is only calculated over the remaining (Amber box) policies.

ii. Reduction of the AMS: the developing countries are required to reduce the AMS to 86.7 per cent of its 1986-‘88 base-period level in ten years (to 80 per cent in six years for developed countries). LDCs do not have to reduce their AMS, but should not increase it either.

iii. De minimis levels of support: developing countries may exclude product-specific government support from the calculation of the AMS that does not exceed ten percent of the production value for any crop. In addition, general support (not specific to any commodity) that does not exceed ten percent of their total agricultural production value is also excluded. For developed countries the *de minimis* level is only five.

Text box 1 Summary of Green Box Policies

The Legal Texts sum up the green box policies in great detail.

General characteristics of measures of government support to qualify for green box membership: transfers from government, not consumers, and no price support to producers of agricultural products. Such measures must have no, or minimal, effects on production or trade.

1. General policies (Research & Development, pest and disease control measures, training, extension and advisory measures, inspection services, marketing and promotion services, infrastructural services)
2. Public stockholding for food security purposes
3. Domestic food aid
4. Direct payments to producers conforming to the two criteria mentioned above
5. De-coupled income support
6. Government financial participation in income insurance and income safety-net programmes
7. Payments for relief from natural disasters
8. Structural adjustments through total production retirement programmes
9. Structural adjustment assistance through investment aids
10. Payments under environmental programmes
11. Payments under regional assistance programmes

Source: GATT, 1994, pp. 56-62

Export competition

i. Reduction of export subsidies: developed countries have subsidized their agricultural exports extensively, depressing prices on some of the most important agricultural world markets and severely disturbing local markets (Ritson and Harvey, 1997). The Agreement contains relatively solid provisions to reduce these subsidies. It bans the introduction of any new export subsidies. Developed countries are required to reduce their subsidized exports by 24 per cent in volume and by 36 per cent in value for each product over six years starting from a 1986-‘90 base. For developing countries the percentages are 14 per cent in volume and by 24 per cent in value for each product over 10 years from the same base. Least developed countries are exempted from the reduction commitments on export subsidies. Subsidies on marketing costs and specific domestic transport costs are allowed to developing countries in order to compensate for poor infrastructure.

Implementation of the commitments

The specific commitments made by the various countries are laid down in the Schedules of Concessions, which every member has submitted to the WTO. In this way all the commitments (tariff rates, other duties, safeguard provisions, market access) could be spelled out by tariff lines. However, it turns out that the commitments are sometimes at odds with the Agreement itself, and yet it is virtually impossible to challenge these concessions, which are the result of a long process of bid-and-offer. Article 13 (called 'Due restraint', but mostly referred to as the Peace Clause) of the Agreement explicitly specifies that domestic support measures and export subsidies that conform fully to the provisions in the various schedules, are not to be challenged nor to be subjected to countervailing measures.[5] In case of agriculture, the peace clause limits this possibility for the first 9 years, after which the Dispute Settlement Mechanism (DSM) might be used to settle inconsistencies.

2.3 Implications of specific regulations for developing countries

The tariffication of non-tariff barriers and the ban on the future use of such measures amounts to a considerable improvement in agricultural trading practices, and the binding of tariffs makes it more difficult to raise tariff levels in a discretionary manner. Import tariffs below prohibitive levels are less restrictive than quantity restrictions since they in principle enable the exporter to sell freely at the prevailing world price (but notice that many EU tariffs for agricultural products still isolate the domestic EU price from the world price). Future negotiations can now start with discussions on reductions of tariff rates. The Agreement on Agriculture defined a framework whose implementation is still incomplete and bears the mark of the compromises needed to conclude the deal. We mention the following.

Tariffication. There are some indications that the newly bound tariffs were inflated and often set at prohibitive levels and ceilings of over 200 per cent were recorded (Valdés and McCalla, 1996, table 1). A possible reason could be that developing countries were in practice allowed to bypass the tariffication process and just deliver their tariff ceilings. Also, the possibility to spread the reduction in tariff rates unevenly among tariff lines, appears to maintain considerable protection for sensitive products, and although the phenomenon of tariff escalation (i.e. tariff rates increase with the level of processing) has been contained, it has not been eliminated.

Access. In the part of the agreement that regulates access, the contracting parties are required to grant a low tariff for an import volume up to a small fraction of domestic production. The tariff quotas are to be allocated on MFN-basis. However, since only a small number of exporting countries is able to fill them, the principle of non-discrimination will often be violated. In fact, several countries, notably the EU, have implemented the market access commitments as part of their preferential import schemes, for example for the sugar that ACP countries may export duty-free to the EU under the Lomé convention. In this way, the principle of non-discrimination has been abandoned from the outset.

[5] Green Box policies are not actionable for GATT retaliatory measures; domestic and export subsidies that are subject to the reduction commitments may be challenged only if they cause injury. The article on Market Access explicitly rules out, among others, the use of quantitative import restrictions, variable import levies and discretionary import licensing.

Domestic policy reform. Developed countries have gradually come to recognize that domestic subsidies distort trade, and that farm support, if any, should be given in the least trade-distorting way. This would imply that price support should vanish eventually and that support should be given as income transfer to farmers who need it, or as regional and infrastructural programmes. The agreement goes at great length in defining subsidies but this could not avoid disputes as to which policies fall in the Green Box, and how high 'excessive rates of inflation' should be to lift AMS commitments (Konandreas and Greenfield, 1996). The exemptions for developing countries, the least developed ones in particular, leave sufficient options to support agriculture, even when the base-year AMS is very low as is often the case for such countries. Developing countries should also be aware of the possibility of notifying commitments in a foreign currency, such as the US dollar or the euro. Since the currencies of most developing countries tend to devaluate faster than these foreign currencies, they will be able to make maximal use of their AMS room by notifying in a stable foreign currency. Be this as it may, providing decoupled income support to farmers always is a costly proposition. Developing countries find it especially difficult to mobilize the necessary resources, and also generally lack the administrative capacity for adequately targeting this support.

Export subsidy reform. Since the export subsidies are specified in explicit schedules over the implementation period, this part of the provisions is relatively watertight but the schedules still leave room for targeted export subsidies for sales to specific regions. Here also developing countries with high inflation will see their export commitments vanish quickly when stated in their domestic currency, and it became common practice to use a foreign currency.

Standards. According to Uruguay Round Agreements, it is legal to restrict imports so as to meet standards, say, regarding the safety of imported meat, but the restriction should not be excessive and be justified on a scientific basis. Clearly, standards restrict trade among developed countries, witness the ban of the EU on beef treated with hormones and genetically modified maize from the USA. They also restrict imports from developing countries, since these are rarely in a position to prove that they meet all phytosanitary requirements.

Safeguards. Countries may invoke safeguards to protect domestic industries in case of material injury inflicted upon them by imports 'at less than normal value', but such anti-dumping regulations have been made more transparent (see Text box 2). This makes it more difficult to restrict imports to keep balance of payments equilibrium and to protect an infant industry.

Dispute Settlement. The new Dispute Settlement Understanding (DSU), also known as Dispute Settlement Mechanism (DSM), is seen as one of the major results of the Uruguay Round (Croome, 1999). WTO members now have access to a unified dispute settlement procedure, covering all multilateral agreements. As a departure from the former GATT regulation, members now have a virtually automatic right to request a panel and the adoption of the panel report is almost automatic as well, except if all parties agree to reject it. Previously, one contracting party of the GATT could already block acceptance of the report (see Hudec, 1993). The DSU specifies strict disciplines and time limits for each stage of the process (GATT, 1994, pp. 404-433). There is a possibility for appeal to the standing Appellate Body which can scrutinize the legal aspects of the panel report (see Palmeter and Mavroidis, 1999). In short, the DSU was seen as a major step

Text box 2 The Agreement on Anti-Dumping

The Agreement on Anti-dumping proved to be one of the main stumbling blocks for completing the Uruguay Round (GATT, 1994, pp. 168-196). This agreement is a revision and an expansion of GATT Article VI that allows members to take countervailing measures when exports are sold at less than 'normal' value. The instrument became popular partly because of its loose definition of the way to compute this normal value and the dumping margin (the amount by which the normal value of the goods exceeds the export price thereof). Its provision that anti-dumping (AD) measures can be applied discriminatorily and without reciprocity was also considered expedient. The new Agreement on Anti-Dumping tries to redress these defects. It specifies more notification requirements before action can be taken, it defines a sunset clause (the AD measure can last only for five years, but there is scope for renewal), and it introduces stricter definitions for dumping and for computation of dumping margins. Yet the approach and concepts have not changed (Finger (1995) and Bronckers (1995)) and anti-dumping measures have not disappeared (Miranda, Torres and Ruiz, 1998). Moreover, as long as the anti-dumping instrument persists, countries can effectively threaten competitors without taking any visible action.
The EU essentially copied the WTO agreement when it revised its own AD legislation (AD enforcement is based on national AD laws and regulations). The European Commission even asserts that the EU regulation is an improvement compared to the WTO Agreement. It is clearer and has tighter rules, as well as jurisprudence from the European Court of Justice. The regulation also introduced the notion of Community interest that provides the anti-dumping authorities with some discretionary power to deny or modify anti-dumping relief. Tighter rules may have been a reason that developed countries use AD-measures less than before but developing countries have apparently discovered the use of AD measures as well, see Figure 1.

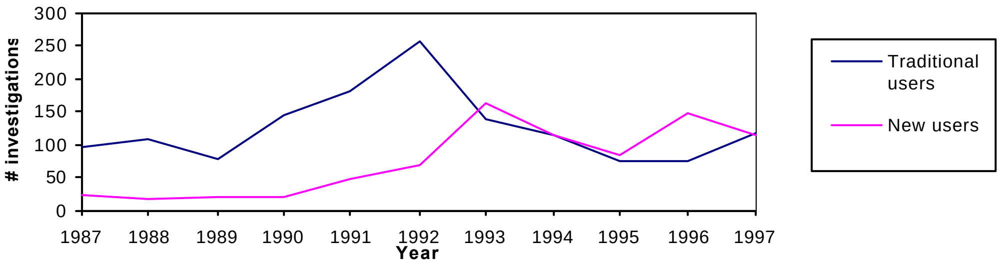

Figure 1. Anti-dumping investigations
Source: Miranda, Torres and Ruiz, 1998

towards a more 'rule-based' instead of 'power-based' organization, that can provide more legal security for developing countries (Whalley, 1996). Observers feel that by and large the dispute settlement mechanism lived up to the expectations (Jackson, 1997, IATRC, 1997, Behboodi, 1998, Hudec, 1998). Most of the disputes for which a case was filed could be resolved satisfactorily, although in the cases of the USA against the EU on bananas and on beef treated with hormones no solution was reached so far, and recently the US have imposed retaliatory tariffs (see WTO, 1999). The number of cases has tripled on a per annum basis, and developing countries participate more actively (see Table 1), both as complainant and as respondent.

Table 1. Participation in WTO dispute settlement cases (April 1994-March 1999)

Complainant	No. disputes	Respondent	No. disputes
US, EU, Japan and Canada	118	US, EU, Japan and Canada	90
Other OECD	22	Other OECD	27
Developing/Transition countries	43	Developing/Transition countries	47
Least developed countries	0	Least developed countries	0

Source: Horn and Mavroidis, 1999

Developing countries were relatively successful, even against developed countries (viz. Costa Rica vs. US in the case on cotton textiles, and Venezuela vs. US on gasoline standards, see WTO, 1999). In these cases, the US chose to comply after the issuance of the Appellate Body report, and changed its policy (Behboodi, 1998). For developing countries this is a new and encouraging development, since it indicates that, despite their limited bargaining power, they can now protect their interests by the rule of law. However, the sanctions are still limited to authorized retaliation. Larger countries may not always be willing to give in under that pressure, despite the negative reputation effects. If non-compliance becomes frequent, the DSU loses its credibility.

To sum up, the Agreement on Agriculture is a major step towards a rule-based system (Jackson, 1997), as only tariffs are left as means to effectuate border protection, and disputes can be settled through detailed procedures. Nonetheless, developing countries did not gain much access through this agreement, and some of them actually lost some of their preferential treatment. Despite pledges to consider carefully the negative effects for LDCs (GATT, 1994, pp. 448-449), no explicit rules for financial compensation have been worked out. For developing countries the benefits are only realized in the medium and long term, through more transparent trading rules, a better operation of the world market, and better market access.

2.4 Reasons for joining WTO

The WTO currently counts 135 members already, and 31, mostly developing countries, have applied for membership. In view of the limitations mentioned above, one may ask why membership is so attractive to them. Three reasons can be mentioned.

First, countries may wish to join the WTO to gain access to either MFN-status or preferences. WTO members have guaranteed MFN-treatment, and new tariff reductions are on the agenda with the prospect of better trade opportunities. For non-members and large exporters, such as China, MFN-treatment is crucial, especially to achieve MFN-status from the USA. Clearly, LDCs often profit much more from preferential trading schemes, which usually go far beyond MFN-status (the Lomé convention provides duty free access for a large majority of ACP exports, see Stevens et al., 1998). However, for the sensitive products these advantages are constrained in volume and, in a new round, persistent erosion of preferences is to be expected as tariffs are reduced and NTBs removed. Reciprocity might again become the dominant principle.

Second, the legal protection offered by the Dispute Settlement Understanding promises to improve LDCs' position in world trade. The DSU remains a cumbersome procedure for small players in world trade as long as the main trading parties (EU, Japan, USA) adopt national legislation not necessarily in conformity with the WTO agreements. LDCs feel especially disadvantaged since they lack the means to fight legal battles, have informational disadvantages and less bargaining power than the world powers. Nonetheless, in some cases developing countries have won disputes against developed countries, although Sub-Saharan countries have not been involved in disputes thus far.

Finally, joining the WTO offers specific privileges with respect to institutional support. The WTO can only ensure the fair and adequate implementation of the new trading system when the underlying procedures are clearly motivated, transparent, accessible to other parties, and readily enforceable. This implies that member states must fulfil an extensive set of monitoring and notification requirements, and undergo a trade policy review frequently. LDCs can only comply with these requirements if they have received extensive technical support and training, and the Geneva-based International Trade Centre and the Integrated Framework for trade-related technical assistance, adopted at the Singapore Ministerial Conference, were set up to this effect (see South Centre, 1999b). However, membership of WTO is not always required for such support, and other international organizations such as FAO provide similar assistance.[6]

Obviously, there are also reasons not to join. Despite all provisions for a Special and Differential treatment, the WTO disciplines are meant to promote international competition, and loss of protection may cause closure of domestic firms, unemployment and social distress. Countries aspiring to become WTO member have to negotiate on all the preferential provisions that exist for developing or least-developed countries on a case-by-case basis. The bound tariffs listed in their Schedules must be commercially viable and are not allowed to exceed the applied rates in a significant way.[7] At the same time, as will be illustrated in the next chapter, developing countries often have undergone the necessary reform already, as part of the structural adjustment programs, and the LDCs are often all too willing to reform as they have little to lose. Furthermore, the LDCs largely rely on the agricultural sector, which was in the past being taxed rather than being supported and for whom trade liberalization consequently leads to an improvement in terms of trade.

2.5 Evaluation of the Uruguay Round Agreements

Ex ante assessments

When the Uruguay Round reached a deadlock – at the time the solution proposed by the chief negotiators was taking shape but still had to gain the support from the negotiating parties – a whole series of studies appeared that were based on model simulations. These studies, summarized in Martin and Winters (1995) and OECD (1998a), reported substantial welfare gains from partial liberalization ranging between 50 and 250 billion US$. The differences in model specifications explain this wide range. Static gains under the perfect competition assumption are much lower than those achieved under increasing returns to scale, product differentiation or dynamic assessments. Increasing returns create welfare gains as markets become larger. Under product differentiation trade widens the scope of brands available to the consumer. And dynamic assessments make it possible to account for cumulated effects. The studies argued that a failure of the Round would mean giving up potential welfare gains for all regions, except Sub-Saharan Africa which would see its trade preferences erode. The results were invoked to convince the GATT members, and to include provisions to compensate the losers, which however never materialized into any additional financial flows to LDCs.

[6] FAO provides its member states with technical assistance on a wide range of trade and WTO related issues. Assistances include analysis of impact of specific trade and production policies in relation to the Uruguay Round Agreements, analytical methodologies for determining the impact of the Uruguay Round Multilateral Negotiations, preparing positions for WTO membership and fulfilling obligations, adoption of Codex Alimentarius standards, food safety and standards, strengthening national food control systems, forestry and fishery issues relevant to WTO as well as intellectual property rights in respect of plant varieties, animal breeds, related knowledges and germ plasm (see website http://www.fao.org/ur/). FAO is currently organizing a worldwide training programme covering fourteen regional workshops in Africa, Asia, Near East, Europe and Latin America aimed at enhancing national capacity on WTO issues so that countries are in a stronger position to meet their obligations and accrue the benefits under the existing WTO Agreements and are better prepared to participate in future negotiations and agenda setting. All developing and "transition" countries will participate in the training irrespective of their status with respect to WTO. For details see website (http://www.fao.org/ur/umbrella.htm).

[7] The authors thank Mr. Thomas Friedheim of the WTO for useful communications on this point.

Ex post assessments

In view of these optimistic *ex ante* assessments, one might expect an elaborate series of *ex post* assessments as well. A positive evaluation would strengthen the credibility of the studies conducted. Unfortunately, this is not an easy task because it is hard to disentangle the GATT effect from other factors, such as weather conditions (El Niño), civil unrest, deviant domestic policies, technological change, and business cycles, whose effect could dominate the trade effect by far. An *ex post* assessment has to control for such factors.

In fact, no studies could be found on the subject, let alone that any independent audit was organized to assert the ex post validity of earlier claims. Several reasons might be envisaged. One is that there are technical reasons related to the update of model specifications and databases. The Uruguay Round Agreements introduced tariffication and while the recording of bound tariffs and NTBs has improved significantly, trade statistics are seldom sufficiently differentiated to reflect the distribution of tariff rate quotas (TRQs) which countries introduced to guarantee minimum import access. The quotas can be allocated in different ways to exporters (traditional shares, first come first serve, auctioning, proportionate, and several more). In practice, the regulation of this trade instrument has grown into an administrative nightmare, since the WTO left this issue open (Josling, 1997).

A second set of reasons relates to the changing environment, characterized by volatile world market prices. This aspect is of special concern for developing countries. As little effective liberalization of agricultural markets took place under the Agreement on Agriculture, this agreement could not be expected to have a major impact on world markets. Almost all *ex ante* exercises only predicted minor increases in most world market prices, combined with small price decreases for commodities undergoing little liberalization, like oilseeds and tropical beverages. For example, the RUNS model found a price impact in the range of –1 to +4 per cent (Goldin and van der Mensbrugghe, 1995), and the FAO World Model found price increases up to 10 per cent, with cereals and oilseeds in the 4-7 per cent range (FAO, 1995c). It was also argued liberalization would make world market prices less volatile.

With hindsight, even this modest prediction proved too optimistic, as agricultural liberalization was even less than anticipated (Tangermann, 1996), and markets stayed segmented as before. Under these conditions, important climatic shocks, government policies that reduced the level of public stocks, combined with crises in South East Asia, Russia and Brazil inserted a large amount of volatility into most commodity markets. Of course, volatility is not a new phenomenon. It has since the seventies plagued developing countries at various occasions (see Figure 2).

Figure 2 illustrates the dominance in the late nineties of swings in commodity prices. The boom in cereals price in 1995/96 was short lived (US Hard Winter wheat prices reached a record level of 263 US$/t in May 1996) and 1996 ending prices were back to ‘normal’ levels, close to the 140-160 US$ range of the early nineties. At that point in time, most commodity forecasts expected a gradual recovery of prices boosted by strong demand from the emerging economies (cf. OECD figures in Table 2), which did not materialize as prices fell even deeper (see FAO data in Table 2). In 1998 cereal prices began to slide and as of September 1999, Hard Winter wheat stood at 115 US$/t and the future prices of wheat at the Chicago Board of Trade for December delivery even 10 US$ lower.[8]

[8] A similar picture emerges for coarse grains (as of September 1999 the level for maize dropped to 70 US$/t), and for oilseeds, see Table 2. Thai white rice, 100% second grade, fob Bangkok did 352 US$/t in 1996 (Jan/Dec), and 239 US$/t by September 1999, while sugar prices (ISA daily price) are now 5.7 cts/lb (September 1999), which is half of the 1989/91 average.

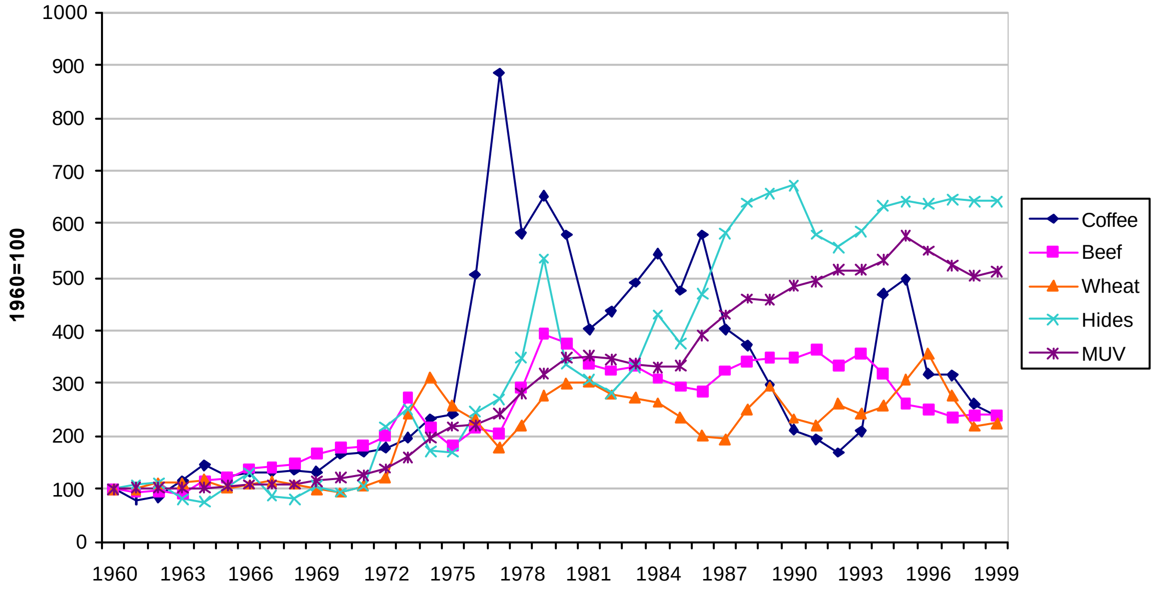

Figure 2. World price indices

Note: MUV is the unit value index in US dollar terms of manufactures exported from the G-5 countries (France, Germany, Japan, UK, and US).

Source: World Bank (1999c).

Table 2. Commodity prices according to FAO and OECD, in US $ per ton

	Wheat		Coarse grains		Oilseeds	
	FAO	OECD	FAO	OECD	FAO	OECD
1992/'93	143	144	97	97	220	247
1993/'94	143	140	113	112	254	270
1994/'95	157	154	104	109	221	262
1995/'96	216	209	159	169	273	304
1996/'97	181	184	135	121	299	304
1997/'98	142	162	112	120	262	252
1998/'99	120	163	95	118	203	239
Sept 1999	115		70		163	
1999/'00		169		124		240
2000/'01		171		127		245
2001/'02		175		129		256
2002/'03		181		132		269

FAO: Wheat is US no.2 Hard Winter, Coarse grains is US no. 2 Yellow Corn, delivered US Gulf ports, Oilseeds is US yellow soybeans, delivered US Gulf ports.

OECD: Wheat is US no.2 Hard Winter, Coarse grains is US no. 2 Yellow Corn, Oilseeds is US soybeans, c.i.f. Rotterdam.

Sources: OECD (1998b). From 1997/'98 onwards the figures are model estimates. More recent projections incorporate the price fall of 1998/'99. FAO Food Outlook, various issues (latest update: September 1999).

Common explanations are weak demand due to the crisis in Asia and Russia, weather shocks (hurricanes, El Niño, flooding and droughts at various places), and a drop in transport costs due to low oil prices. However, the sharp reduction of demand for feedgrains during the Asia crisis suggests that there might also be a relatively new phenomenon at play. As emerging economies reach income levels where meat consumption takes off sharply, a rationalization of livestock production sets in. Traditional feeding systems, relying on high shares of by-products and waste in total feed intake, are replaced, or at least supplemented, by modern systems which depend on purchased feed (grains and grains substitutes from oilseeds and manioc). During the transition period, demand for meat has a strong multiplier effect on demand for purchased feed.[9]

In this light it is important for LDCs to maintain sufficient room for invoking safeguards and keeping their bound tariffs at a level that enables them to raise import levies in situations with extreme price volatility, when full price transmission would lead to unacceptable fluctuations in food prices. Full price transmission could especially affect the landless poor whose capacity of adjusting to price shocks is generally very limited.

Secular trends

Figure 2 also indicates that since the early eighties, agricultural commodities suffer a terms of trade loss on the world market with respect to a non-agricultural price index. It would seem that the Prebisch-Singer hypothesis of the 1960s, refuted by Johnson (1967b) for the period until the early sixties, deserves renewed attention (see also Cuddington, 1992; Sapsford and Balasubramanyam, 1994; and Bloch and Sapsford, 1997 for recent attempts at rehabilitating this hypothesis).

Classical arguments for prices of primary commodities to fall are that their consumer demand is inelastic because of satiation, their supply inelastic because producers have fixed inputs (land, their own labor, livestock herds) with little alternative use, and that technical progress forces a secular downward trend in prices. In addition, the homogeneous nature of primary products, and the large numbers of producers make it more difficult to capture any rents through imperfect competition. Finally, the structural adjustment policies and the recent reduction in official development aid have pushed up the exports from LDCs in volume terms, and this tends to depress prices further.

The secular fall in prices is of special importance for LDCs, which mostly depend on primary commodities for their export revenue. World wide various NGOs have sought to curb the trend by creating channels for “fair trade”, see FLO (1999), through which farmers are assured of a stable and relatively high price for their product. This can be viewed as a special form of product labeling and vertical integration, to which we return in Chapter 6, but which cannot reverse the underlying secular trend.

Ex-post evaluation of the Agreement

There is in the literature no comprehensive evaluation of the impact of the Agreement on Agriculture, and for the reasons stated, it would also be difficult to arrive at objective conclusions, due to the large number of confounding factors. Therefore, the assessment of the implementation of the agreement has generally been of a descriptive nature. First, where actual tariffs were below their bounds, the reduction of the tariff bounds as imposed by the Agreement was not always accompanied by a reduction of actual tariffs. Second, the process of tariffication did actually lead to higher tariff protection than the import restricting measures they were

[9] The mechanism can be illustrated as follows. Suppose that feed demand is 100 units, out of which 80 are supplied from traditional sources, and 20 are purchased, and that demand drops to 90 units. Since traditional feeds largely consist of residuals, their supply remains more or less constant. Hence purchased feed demand becomes 10, i.e. is cut by half. In this case a 10 percent reduction in demand causes a 50 per cent cut in purchased feed demand. And if demand recovers to 100 units afterwards, this will imply a 100 per cent rise in purchased feed demand.

supposed to replace. This phenomenon is known as "dirty tariffication" and was widely documented (see Ingco, 1995; Tangermann, 1996). Table 3 illustrates it for selected products.

Table 3. Border protection for selected agricultural goods, in estimated tariff equivalent (per cent)

	Wheat			Sugar cane			Meat		
	Pre-UR actual 1986/88	Post-UR Bound 1995	Post-UR Bound 2000	Pre-UR Actual 1986/88	Post-UR Bound 1995	Post-UR Bound 2000	Pre-UR Actual 1986/88	Post-UR Bound 1995	Post-UR Bound 2000
European Union	106	170	82	234	297	152	96	96	76
United States	20	6	4	131	197	91	3	31	26
Japan	651	240	152	184	126	58	87	93	50
Brazil	98	45	45	n.a.	55	35	-52	25	25
Mexico	-1	74	67	-58	173	156	42	50	45
Other Latin America	-17	34	34	41	85	80	n.a.	51	47
Nigeria[a)]	249	-	150	32	-	150	n.a.	-	150
South Africa	10	75	47	98	124	105	40	150	81
Other Sub-Saharan Africa[a)]	10	-	133	44	-	100	n.a.	-	100
Maghreb	36	196	151	64	220	165	n.a.	303	213
Mediterranean	25	169	152	-13	107	93	n.a.	166	149

[a)] Nigeria and other Sub-Saharan countries were allowed to bind only in the final period.

Source: Ingco (1995)

The commitment to open markets by means of low tariff quotas (TRQs) up to five per cent of domestic consumption also appeared to have negative side effects, as the GATT did not specify how rights to import should be distributed among traders. Various practices have developed and there currently is great uncertainty about the specific implementation and who gets the rents. Duponcel (1998) finds some cases, in EU-EFTA trade, where rents accrue to exporters and some where they accrue to importers but no systematic inquiry has been published so far. Skully (1999) discovers that there exist seven legal ways of administering these TRQs.

The Uruguay Round Agreements made attempts to remove all NTBs and to replace them by tariffs. Nonetheless, it allows for exemptions, to be notified to the WTO. Countries normally are far from the WTO's ideal of a completely flat tariff structure with ad valorem duties only. Daly and Kuwahara (1998) report on the extent to which the EU, VS, Japan and Canada deviate from this ideal, based on their nominally applied MFN rates. It appears that virtually all tariffs are bound, and that the overall levels of tariff protection are low. After the Uruguay Round the simple average of MFN rates is around 5.5 per cent. Yet, many tariff 'spikes' remain, which are defined in the study as tariff rates above 15 per cent. In the EU the occurrence of tariff spikes even increased after the Uruguay Round (from 5.7 to 9.2 per cent), while it roughly halved in the other countries (see Table 1 of Daly and Kuwahara, 1998, for other measures as well). Tariff escalation creates a further derogation from a flat tariff structure. In the US, Japan and Canada, post-UR tariffs remain higher for finished goods than for raw materials (including agriculture). In the EU, tariffs for finished goods are also higher than those for semi-finished goods. Tariffs on raw materials are higher than on either finished or semi-finished goods, however, due to the CAP. The authors also present indicators for non-tariffs barriers, shown in Table 4 for the EU but the outcomes are similar for the US, Canada and Japan. The first indicator, the frequency ratio, measures how many tariff lines are affected, the second, the import coverage ratio, attaches weights to these lines. Both indicators show a steady decline of the use of NTBs.

Table 4. Pervasiveness of different types of NTBs in the EU, percentage

	Frequency ratio (F)			Import coverage ratio (IC)		
	1988	1993	UR	1988	1993	UR
All NTBs	27.3	27.7	8.2	11.6	10.6	3.8
Core NTBs	25.9	25.2	4.3	9.4	7.6	1.3
Quantitative restrictions (QRs)	20.4	20.1	1.7	6.5	6.2	0.8
Export restraints	15.9	15.0	0.0	4.7	4.3	0.0
Non-automatic licensing	5.1	5.6	1.5	1.9	1.9	0.7
Other QRs	0.2	0.2	0.2	0.0	0.1	0.1
Price control measures (PCMs)	13.2	10.6	3.2	4.9	3.0	0.6
Variable charges	9.2	9.5	2.4	2.8	2.7	0.6
AD/CVs	1.1	1.1	0.9	0.7	0.2	0.1
Other PCMs	3.1	0.0	0.0	1.4	0.0	0.0

Source: Daly and Kuwahara (1998)

Note: NTBs are non-tariff barriers, AD/CVs are anti-dumping/countervailing duty measures

The Uruguay Round Agreements and Africa

It has often been noted that Africa’s exports classified by main groups lean heavily on food and agricultural raw materials (27 per cent of total), compared to 19 per cent for manufactures (excluding fuels), see Table 5. For the average of all LDCs, these shares are 15 and 54 per cent, respectively.

Table 5. Exports by main SITC group, 1990, in percent

SITC group	Ethiopia	Sub-Saharan Africa
All foods	63.3	18.5
Agricultural materials	25.1	8.3
Fuels	6.2	36.3
Ores and metals	-	16.6
Manufactures	5.3	18.8
Chemicals	2.0	3.0
Other manufactures	3.2	13.8
Machinery and transport	0.6	2.0
Unallocated trade	-	1.5

Source: Harrold (1995), Table 1.

Most of the products from Sub-Saharan Africa (80 per cent) are exported to developed (industrial) countries. For LDCs as a group this is 18 per cent. As shown in Table 6, Europe is the leading export destination. This is due to traditional ties, colonial links and the above-average preference of the EU for Lomé countries.

Table 6. Direction of Sub-Saharan Africa's exports, 1991, in percent

Exports to	From: Ethiopia	From: Sub-Saharan Africa
Europe	40.3	51.2
North America	11.2	22.1
Japan	14.9	5.6
Other industrial countries	0.2	1.4
Eastern Europe	4.8	0.9
Socialist Asia	0.2	0.7
Developing countries	26.3	15.4

Source: Harrold (1995), Table 2.

The EU imports almost all agricultural products from Africa free of duty, and for minerals and metals the tariffs are very low. Thus, African products are nearly free of import tariffs. In fact, the average tariff faced by the LDCs in Sub-Saharan Africa after the Uruguay Round Agreements is found to be less than one per cent, and with respect to the EU only 0.23 per cent (Table 3, Harrold (1995)). NTBs are more important: they affect 13 per cent of the value of SSA's exports to the OECD countries, but in case of Ethiopia it is found to be only 1.8 per cent, and 3.3 per cent to the EU (Harrold (1995), Table 17).

Since the Uruguay Round Agreements focused on lowering trade barriers on an MFN basis, the countries that enjoyed preferences found their preferential margins diminished. As the LDCs in Sub-Saharan Africa receive extensive multiple tariff preferences in OECD markets (under the Generalized System of Preferences or the Lomé Convention), the Uruguay Round Agreements meant a loss to them.

2.6 Preparations for the new round

From Marrakech to Seattle: wrapping up and preparations.

During the Uruguay Round, the model-based calculation of welfare gains from tariffication and tariff reductions proved effective in convincing the negotiating parties. The new round of trade negotiations is also likely to be opened with a fresh cycle of calculations in the same spirit.[10] And to the extent that the models will be based on the same paradigm, substantial welfare gains will be shown from trade liberalization, though occasionally some countries may incur losses.[11] Yet the argument is unlikely to carry as much weight as during the UR because MFN rates are now lower, especially for manufactures and the remaining tariffs presumably relate to the more sensitive and stubborn cases. There is also the lack of credibility since no proper ex post assessment of the UR has been made. Finally, the scientific paradigm has shifted in many circles, as economists have come to recognize the prevalence of market imperfections resulting from imperfect competition, increasing returns, and non-rivalry. For example, whereas models that assume fixed monopoly margins can sometimes be shown to yield welfare gains under trade liberalization, this kind of result is much less probable if international cartels are given the possibility to capture the rents freed by GATT rounds. We return to this aspect in Chapter 5 below.

Current preparations for the new round primarily seek to set the stage. WTO members have communicated their initial positions by a notification to the WTO.[12] The important occasion is foreshadowed by an upsurge of publications with comments and suggestions for the coming

[10] The World Bank is organizing an integrated program of research and capacity building to enhance the participation of developing countries in the WTO 2000 negotiations in agriculture, see website http://www1.worldbank.org/wbieb/trade/. The World Bank recently organized a kick-off meeting (Conference on Agriculture and the New Trade Agenda from a development perspective: interest and options in the next WTO negotiations, Geneva, October 1-2, 1999), where a number of quantitative and qualitative studies were presented.

[11] The new studies reiterate the earlier assertion of multilateral trade liberalization leading to substantial welfare gains. For example, the Australian Ministry of Foreign Affairs and Trade (DFAT, 1999) commissioned a study based upon model exercises conducted with a static general equilibrium model as well as a dynamic macroeconometric model. It concludes that the welfare gains from halving trade barriers are around US$400 billion annually. Eliminating barriers entirely would generate gains of around US$ 730 billion annually. These are even presented as conservative estimates, though the ex-ante estimates of gains from the UR only reached US$ 200 billion annually (OECD, 1998a).

[12] The official positions are listed at http://www.wto.org/wto/minist/seatdocs.htm.

round. Krueger (1999) argues that the developing countries have much to gain from an open multilateral trading system and suggests holding a broad round with a wide sector coverage, and with ample room for developing country interests. These might include pressing for full implementation of the Uruguay Round, especially the part on the phasing out of the Multifiber Agreement, keeping labor and environmental standards outside the GATT, and expanding the GATS to include the possibility for construction workers to work abroad. This is very important since it means that the sensitive topic of movement of natural persons enters the WTO consultations (Srinivasan, 1999). Michalopoulos (1999) agrees that an active participation is crucial for developing countries but points out that many of them, especially the smaller low income countries do not have an adequate representation in Geneva and hardly participate in the Organization’s activities. Regarding agriculture, Josling and Tangermann (1999) review the implementation record of the main players and review the various opening bids for the new round. They notice little enthusiasm for further talks on agriculture, and expect that these will only start with a “feeling of resignation.” Blandford (1999) concurs with this view and outlines a wide range of options for the position of US government, from protectionism to free trade. He also expects further liberalization to be especially difficult this time since it will now affect sectors such as dairy and sugar that are more heavily protected than those tackled during the Uruguay Round and can mobilize more lobbying strength. The EU will strongly focus on securing the Blue Box (Swinbank, 1999). It has little choice, as Agenda 2000, the most recent EU reform (to be discussed in chapter 5), mainly dealt with internal CAP problems while meeting the existing GATT export commitments, as opposed to anticipating the next WTO round.

Most authors concur on the present status of the traditional issues (market access, domestic support, export subsidies). The UR has put the machinery in place but hardly achieved any effective liberalization. Yet, as mentioned in the introductory chapter, opinions differ widely among both academics and policy makers as to the next steps to take. The USA, Canada, Australia and other CAIRNS group countries focus on trade liberalization in agriculture. As agricultural exporters, they would like to see their market access improved and the tariffs of their customers reduced, and seem to reject any non- Green Box policies. They also aim at maximal reduction of trade-distorting domestic support, and seek elimination of all export subsides. The EU on its part tries to safeguard its (Blue Box) income support to agriculture, preferably via the existing methods of area and headage premiums, wants to see the multifunctional role of agriculture recognized, and the Peace Clause renewed. Furthermore, the EU seeks recognition of its non-trade concerns such as animal welfare, environmental standards, and labor standards. These issues will be discussed in detail in Chapter 5. Japan aims at maintaining Blue Box measures and market protection to maintain food security. It also stresses the multifunctionality of its agriculture. Developing countries emphasize the special treatment enshrined in GATT law, and try to preserve their preferences. They find the TRIPs agreement too strong, while the US seek to strengthen it further but have become afraid of reopening the dossier. Finally, if in the course of the round China accedes to the WTO, this will have an important impact. In China, agricultural trade liberalization may not only lead to increased imports of cereals, meat and dairy. It might also create enormous exportable surpluses on markets for cash crops such as jute, sugar and cotton. These could pose a serious threat to developing countries unless China commits to strong restrictions on its subsidized exports.

All this obviously bypasses the main concerns of non-governmental organizations and political movements who oppose the WTO process because they fear that, by promoting standardization and conformity, it seriously threatens the cultural heritage and even the identity of local communities, not to mention the ecology (see George, 1999, and IISD, 1999). We return to these fundamental issues in the final chapters.

Chapter 3

The Uruguay Round Agreements and agricultural development in a least developed country: The case of Ethiopia

This chapter adopts the perspective of Ethiopia as a typical least developed country and discusses how current WTO-regulations affect the overall development policies of the country.[13] The next chapter enters into commodity-specific detail.

3.1 Current economic situation

Ethiopia belongs to the poorest countries in the world. Its per capita GNP of 110 US$ is the very bottom, equal to that of the war-torn Democratic Republic of the Congo (World Bank, 1999b). Ethiopia is the second most populated country in Sub-Saharan Africa. Its fast growing population of 60 million people has an average life expectancy at birth of only 43 years. Three-quarters or more of the population have no access to safe water or sanitation, and almost two-thirds of the adult population is illiterate (UNDP, 1999). Daily *per capita* food supply is 1,860 Kcalories or 15 per cent below the average for all Sub-Saharan Africa and far below estimated daily requirements (FAO, 1999). Recent estimates suggest that more than half of the population is permanently undernourished (FAO, 1998d). Nonetheless, the country has considerable potential for growth. Agricultural productivity can be raised substantially through use of fertilizer and improved seeds.

Of the 3.5 million hectares suitable for irrigation, only about five per cent is irrigated (FAO, 1995a). Ethiopian livestock herds are vast and count up to 30 million cattle, 22 million sheep and 17 million goats, but the animals are in poor health and produce little. The soils harbor a wide range of mineral deposits whose exploitation contributes only 0.3 per cent to GDP. Finally, the installed hydropower capacity barely reaches one per cent of the estimated potential.

Close to half of the country consists of highlands (see Figure 3), causing rainfall in Ethiopia to be substantially higher than in surrounding, low-lying countries. The main rainy season (‘Meher’) brings rain by southwesterly winds and lasts from July to September. A second, less important rainy season (‘Belg’) brings rain from the southeast from February to April. Most of the population lives in the highlands, where the climate is humid and cool, and thus free of tropical diseases. Farms generally combine crop and livestock activities, with on average 1-2 hectare of cropland and a small number of livestock per farm. In the lowlands the climate is hot and dry and nomadic livestock herding is the main farming system. In the northeastern parts of the country, rainfall is less regular and soils have low fertility due to centuries of dense cultivation. This area is particularly vulnerable to crop failures and famine.

Agriculture is the dominant economic sector, accounting for about half of GDP and for more than four-fifths of employment and export earnings. Only 11 per cent of the land is cropped annually, but insufficient rainfall, unsuitable soils and the need to keep land for grazing limit area expansion. About 40 percent of Ethiopia’s territory is too arid, as shown in Table 7, whereas

[13] This chapter is based on the background reports Kidane Mariam (1996), Merbis et. al (1997a), Overbosch (1996) and Wolde Mariam (1996).

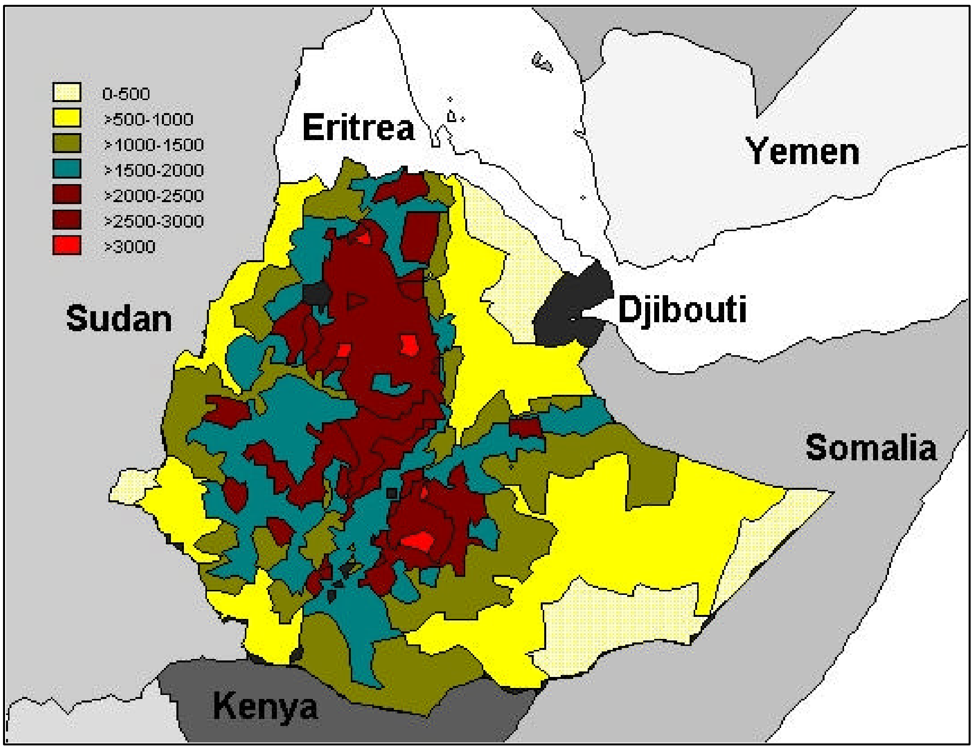

Figure 3. Ethiopia: Altitude (m) map.
Source: FAO, 1998c.

another 39 per cent has sufficient rains but soil restrictions make it only marginally suitable for annual crops. The soils are either too steep, too stony, too shallow, too wet or have impermeable layers[14]. Of course, part of the land with steep soils can be used for perennial crops, such as coffee, tea or fruit trees, and other land might still be suitable for livestock grazing and browsing. Just 11 per cent of the land has both sufficient rain as well as suitable soils for rainfed annual crop cultivation, while the remaining 8 percent is only moderately suitable due to less severe soil restrictions, which mainly refer to moderate slopes and bad drainage conditions, and can be eliminated with appropriate land management. The areas most suitable for rainfed annual crop cultivation are found in southern and western Ethiopia, as shown in Figure 4, which implies that actually in large parts of the country rainfed arable agriculture is practiced on land that is only marginally suitable for that purpose.

Table 7. Land availability in Ethiopia for rainfed annual crop cultivation, in per cent

Unsuitable (too arid)	40.6
Marginally suitable	39.0
Moderately suitable	8.4
Suitable	11.0

Source: derived from FAO, 1998b

[14] Land with a crop growing period of less than 75 days is considered too arid. Soils with a slope of more than 15 percent are considered too steep, soils with stones on more than 50 percent of the surface are considered too stony, and soils with a depth of less than 25 cm are considered too shallow. Slopes of less than 8 percent and stoniness of less than 15 percent of the surface are considered not to impose serious constraints on arable agriculture.

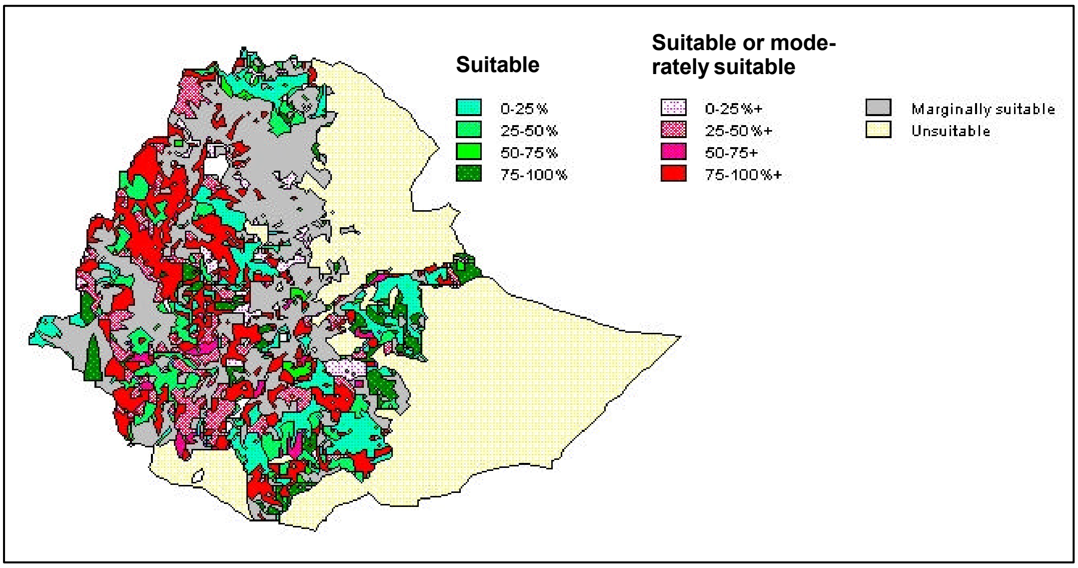

Figure 4. Ethiopia: area share of land suitable for rainfed arable agriculture

Source: FAO, 1998b

About 95 per cent of cultivated land is farmed by small-holders who mainly produce for subsistence needs, using low yielding traditional technology with hardly any improved seed and very little fertilizer. The remainder five per cent of the cultivated land is under large-scale state farms. Land erosion poses a serious problem in several areas, due to deforestation and overgrazing of communal lands (UNEP, 1992). The cropping pattern is diversified according to differences in altitudes and temperature. Cereals are the major crops, occupying more than 60 per cent of the farmed land. Main cereals are maize, teff, sorghum, wheat and barley. Other important food crops are oilseeds and pulses. Coffee is the main export crop, but it only occupies 3 per cent of the cultivated land.

The industrial sector contributes about 11 per cent to GDP and is largely engaged in the processing of cereals, hides and skins, sugar and tobacco. It is mainly oriented to the domestic market and state-owned enterprises account for about 70 per cent of its total value added.

After a period of heavy state control over the economy, a policy of transition to the market economy has been pursued since 1991. A gradual liberalization has taken place that allowed economic growth to pick up from 1993 onwards (see Table 8). Agricultural output rose significantly. The years 1995 and 1996 even produced bumper crops, that made the country almost self-sufficient in food. This was the combined effect of good rains, improved availability of inputs at lower prices, improved marketing opportunities as well as intensified extension activities through demonstration plots. In addition, stronger competition in trade has reduced the trade margins and made prices more favorable to farmers. However, agricultural production remains vulnerable. Three successive failures of the 'Belg' rains have resulted in current food shortages in several areas, affecting about 8 million people (FAO, 2000).

Regarding GDP measured in constant domestic prices, Table 8 reports considerable growth, with an average of 7.5 per cent from 1993 to 1996, but when measured in US dollars, the level of GDP per capita has hardly risen, because of the persistent devaluation of the Birr, not matched by the rise in the consumer price index. Indeed, if the exchange rate is corrected for purchasing power parity, an economic growth per capita of 6.1 per cent results. Nonetheless, even in terms of purchasing power, Ethiopia is one of the poorest countries in the world. In the

Table 8. Economic recovery and growth in Ethiopia in the 1990s

	1992	1993	1994	1995	1996	1997	Growth '92-'96
Exports (million US$)	169.9	198.8	372.0	423.0	438.1	557.4	26.7
Cereal output (million tons)	5.3	5.2	6.7	9.4	9.5	7.2	15.7
Food availability (cal/cap/day)	1640	1694	1736	1881	1858		3.2
Growth rates (per cent)							
- GDP	-3.7	12.0	1.6	6.2	10.6	5.6	7.5
- value added Agriculture	-2.7	6.1	-3.7	3.4	14.7	3.4	4.9
- value added Manufacturing	-5.5	36.1	8.9	9.0	7.6	5.9	14.8
- value added Services	-4.8	16.0	7.9	9.3	7.0	7.8	10.0
GNP per caput (USD)	110	120	110	110	110	110	0.0
GNP per caput, (1987 PPP $)	300	350	340	360	380		6.1
Consumer Price Index (1990=100)	150	155	167	184	175	168	3.9
Exchange rate (Birr / US$)	2.80	5.00	5.47	6.16	6.35	6.71	22.7

Sources : IMF Balance of Payments Yearbook 1998 for exports; FAO for cereal output and food availability ; World Development Indicators CD-ROM 1998 and 1999 for GDP and GNP ; IMF International Financial Statistics Yearbook 1998 for CPI and exchange rate

Note: Data for 1992 still include Eritrea

most recent World Development Report (World Bank, 1999a), the per capita GNP of Ethiopia is 500 PPP dollars of 1998 and only surpasses Tanzania (490) and Sierra Leone (390).

Since 1992 officially recorded exports returned to levels comparable to those recorded in the 1980s (see Table 9). Ethiopia mainly exports agricultural commodities. Coffee, hides and skins are sold to developed countries, especially the European Union. Its exports to Africa are modest and largely directed to its direct neighbors. Imports have risen as well since 1992, and are for a considerable share paid out of official transfers. Remarkable is the large contribution of private transfers from Ethiopians abroad and non-governmental organizations. In recent years, this item became higher than public transfers. Foreign earnings from services also are important and are mainly attributable to Ethiopian Airlines. The table does not show any figures for direct foreign investments, but according to IMF these are low, though growing in recent years (IMF, 1999). External debt has fluctuated around 70 per cent of GDP since 1992, but almost doubled when recently Ethiopia acknowledged debt to Russia inherited from the former Derg regime.

The growth experienced since 1992 can be attributed to a post-war recovery as well as gains from trade liberalization. Further economic development will increasingly be hindered by supply constraints, such as the poor educational and health status of the population, limited production capacity, institutional constraints, and lack of infrastructure. Road density is very low, the condition of the roads is often very poor, many rural areas are not linked to all weather roads, and pack animals play a central role in transportation. The telephone network is largely concentrated in Addis Ababa and does not function well. Consequently, domestic markets are not well integrated, even for main commodities such as cereals. This reduces the farm prices in surplus areas and discourages agricultural growth (RESAL, 1999).

However, while the beginnings of an economic recovery were seen in the nineties, this period also witnessed a worsening of the relations with Eritrea. In July 1997, Eritrea introduced own currency, ending its monetary union with Ethiopia. Next, a border dispute escalated in May 1998 with the Eritrean occupation of disputed territory. Trade with Eritrea came to a halt and international rade flows to and from Ethiopia were diverted from Eritrean ports to Djibouti.

Table 9. Balance of payments of Ethiopia in recent years, in millions of U.S. Dollars

	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99
Exports, f.o.b.	222	280	454	410	599	602	494
- coffee	126	158	288	273	355	420	279
Imports, c.i.f.	-1052	-915	-1063	-1413	-1403	-1519	-1509
Trade balance	-829	-635	-609	-1003	-804	-917	-1015
Services	73	90	121	139	133	139	92
Income	-96	-79	-60	-44	-42	-91	-63
Private transfers	248	247	311	313	258	317	372
Official transfers	400	285	428	392	226	261	239
Current account	-204	-92	190	-203	-230	-292	-374
Capital account	160	222	-62	166	29	-152	-117
Overall balance	-44	130	128	-36	-201	-444	-492

Source : IMF, 1999

Figures for 1998/99 are preliminary estimates

These restrictions and the associated increased military spending endanger the already fragile economic prospects of both countries. Although the shift to Djibouti does not appear to have affected exports and imports yet, military spending has increased from 2 per cent of GDP in the fiscal year 1997 to 6 per cent in 1999, partly at the expense of public investments. The depreciation of the Birr has accelerated in 1999 and demand for new investment licenses has slowed down, possibly as a reflection of concerns about the war (IMF, 1999).

3.2 General economic policies

Since the regime change in 1991, structural adjustment policies have redefined the role of government, but the country has only partly succeeded in shaking off the legacy from its centrally planned past. Until 1974 under the imperial government, modest economic development took place with the establishment of commercial, large-scale farms and processing industries like meat plants and tanneries, often as foreign direct investments. Exports were growing and diversifying into cereals, oil crops, pulses, meat and meat products. During the military (Derg) regime from 1974 to 1991 the medium and large-scale enterprises were nationalized and trade was heavily regulated, or monopolized by marketing corporations. Farmers were compulsorily organized in cooperatives and agricultural support focused on state farms and the cooperatives. As a result, economic growth slowed down and per capita agricultural production even dropped. Production was increasingly for domestic demand, food exports declined and exports became concentrated in coffee and hides and skins, as before. In its later years, the Derg regime took some small steps towards a market economy, but a real transition started only after the change of government.

The new government that took control in May 1991 has initiated four major policy changes. First, a program of democratization and regionalization of government was effectuated. The country acquired a new constitution that specifies a federal structure with regional governments ruling over newly defined regions. And Eritrea became independent in 1993. Second, the transition to a market economy was initiated which led to redefinition of the economic role of government, while many structural adjustment policies were implemented in consultation with the IMF and the World Bank. Third, the overall development strategy of 'Agricultural Development Led Industrialization' designated the agricultural sector and its farmers as the main engine of economic growth, to supply export commodities and raw material for the processing industry. Fourth, it was decided to integrate Ethiopia into the global economy by progressively opening up the domestic economy to international competition. This strategy was effectuated through the following policies.

Foreign Exchange Regime Liberalization. In October 1992 the Ethiopian Birr was devalued from 2.07 to 5 Birr per US dollar, and in May 1993 a fortnightly open auction of foreign exchange was established, where government offered the valuta earned by exports to importers. Imports could temporarily also be paid with ‘franco valuta’, which traders had obtained by private transfers or otherwise. The easier access to foreign exchange at predictable rates is said to have re-routed exports back into the official channels. In 1996, the frequency of the auctions was increased to weekly, the export proceeds surrender requirement was eased and foreign currency bank deposits were permitted. In September 1998 a further liberalization step included the start of retail trade in foreign exchange by banks. Export proceeds surrender requirements were eliminated, and the foreign exchange is now to be held at banks with a four week period for conversion or use for imports, while 10 per cent can be kept in foreign currency deposit accounts. Currently, government intends to establish an inter-bank market for foreign exchange that will eventually replace the official auctions. This step-wise liberalization of the foreign exchange regime since 1991 has considerably increased the incentives to export.

Domestic trade and transport deregulation. In December 1992 the fixed transport routing system (‘Ketana system’) was abolished and private transportation was permitted with free route choice and transport charges. The issuing of a large number of trade licenses has fostered trade though the gains from this deregulation were diminished by the appearance of so-called ‘kella’ charges, i.e. taxes on trade levied at checkpoints by local or regional governments, which also created additional uncertainty and time delays in domestic trade. In recent years many of these checkpoints were dismantled.

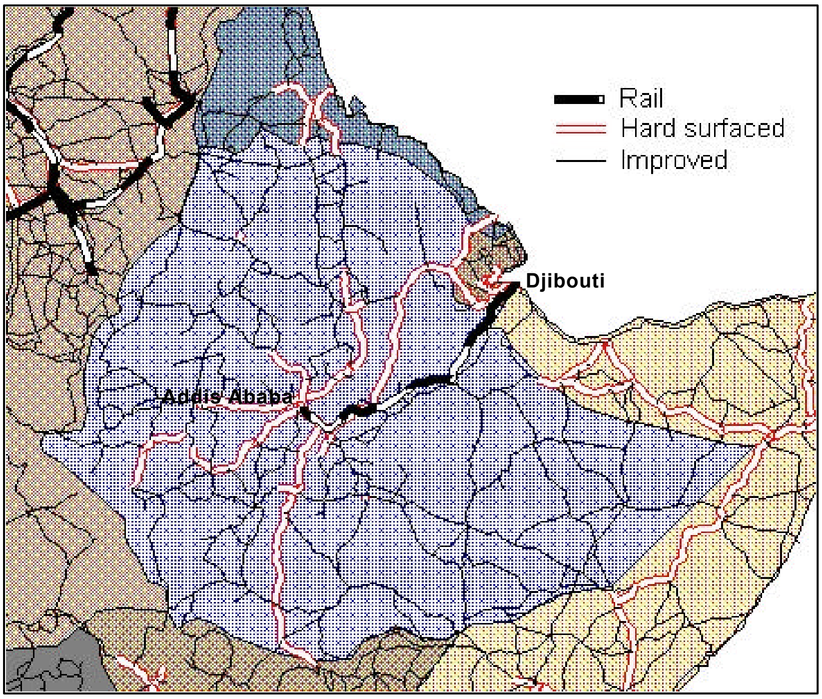

Figure 5. Ethiopia: transport infrastructure

Source: FAO, 1998c

Investments in Roads. An ambitious Road Sector Development Program was launched in 1997 that seeks elimination of the backlog in road maintenance and rehabilitation as well as expansion of the rural road infrastructure (Figure 5 shows that Ethiopia has only one single-track railroad to Djibouti and a very limited number of hard-surfaced roads). The aim of the program is to reduce the proportion of farms that are more than half a day's walk from the nearest all-weather road. The target is to achieve a reduction from 75 per cent to 50 per cent within five years, and to 25 per cent in ten years but this might be too ambitious as road investments have until recently been hampered by insufficient domestic construction capacity.

Price deregulation. The previous Government's strictly regulated price system was gradually dismantled, except for petroleum products.

Abolishing export taxes and lowering import tariffs. All export taxes and subsidies were abolished in the early days of the reform period, except the export taxes on coffee, the major export commodity. Import tariffs were standardized and lowered. Instead of the previous widely dispersed rates, the number of tariff bands was gradually reduced to 7 and the number of duty free items has increased. The maximum tariff was reduced considerably over the years, in 1993 from 230 per cent to 80 per cent, followed by step-wise reductions to 60 in 1997, 50 in 1998 and 40 per cent by 1999. The average import tariff is now 19.5 per cent, and a further reduction of import tariffs is planned. So far, the reduction in import tariffs has not been compensated by an increase in any other tax, but future reductions will be accompanied by a raise in domestic indirect taxes, including a wider coverage of the sales tax and an increase in excise taxes.

Reduction of fiscal deficit. The structural adjustment policies have caused the fiscal deficit to decline, especially through a drastic reduction of defense expenditures. Meanwhile, expenditures on economic infrastructure such as roads showed a considerable increase.

Autonomy and privatization of state enterprises. In 1992, all state enterprises were declared autonomous. This amounted to severing their financial ties to the government budget and freeing the enterprise management from direct government control, though the enterprises remained state owned, with a board of directors appointed by government. It is not completely clear how this autonomy was effectuated in actual practice, for example, how the meat products industry could survive with its full work force despite its financial losses and its low capacity utilization. After autonomy came privatization. In 1994 an Ethiopian Privatization Agency was established[15] and the privatization of some state owned enterprises was announced. Considerable progress has been made since in privatization of small and medium sized enterprises, especially in the services sector, but the privatization of larger, mostly industrial, enterprises and state farms has lagged behind. The process is complicated further due to its fiscal implications as state ownership also serves as a channel for raising central government revenue. Privatization of state enterprises implies a shift of the tax base from the central to the regional government, as all taxes and profits raised from a state enterprise accrue to central government, whereas for private enterprises several taxes will accrue to local government.

Investment incentives and deregulation. In 1992, a new investment law was issued, granting tax privileges and other incentives to licensed investments, including an import duty drawback

[15] The Ethiopian Privatization Agency has its own Internet site (www.telecom.net.et/~epa) that provides a list enterprises to be privatized, with short descriptions of each of these.

scheme for imported raw materials and intermediates used in exported commodities. Despite a further adjustment in 1996, the law still seems to constrain investments in practice. A minimum amount of half a million US dollars is required for all foreign investments.[16] Several sectors, including trade and tanneries, are reserved to domestic investors, while investments in other sectors, including fertilizers, are only permitted via joint ventures. In addition, all investors need a license to operate, which is supplied at bureaucratic discretion and is sometimes not granted even in cases where no tax privileges are being requested. Another factor that hinders foreign investments is lack of land. According to the US Embassy ‘At present, acquiring land is an arduous process and lease prices, particularly in Addis Ababa, are expensive’ (US Embassy, 1999). In 1998, the investment code was liberalized further when the privileges for domestic investors were made to apply to Ethiopian emigrants as well, and foreign investments in telecommunications and power generation were permitted. Recently Ethiopia has published a Investment Guide on the Internet, with support of UNCTAD and the International Chamber of Commerce, and the Ethiopian Investment Authority has started worldwide distribution of information on opportunities for foreign investments in Ethiopia through its Internet-site.[17]

Priority for smallholders and for cereals. In 1993, the priorities for agricultural research and extension services were redefined. Agricultural research was to concentrate on improvement of production of food crops such as cereals, of the export crops coffee, cotton and sugarcane, and on research on drought resistant varieties and soil conservation. Extension services were reoriented towards smallholders. At the same time, management of extension services has been transferred to the regional governments. In practice, extension work became loosely organized with much autonomy for the extension workers, who by-and-large focused their services on cereals and other staples and less on export crops. In 1998, some 2.5 million farmers were benefiting from their services. In the near future, extension work is to be expanded further, with emphasis shifting towards cash crops, and extending its scope to incorporate animal breeding, soil and water conservation, forest development and irrigation.

Liberalization of trade in agricultural inputs. The government monopolies on production and trade in improved seeds and fertilizer were lifted in 1992 and 1993, respectively. Since 1992 seeds are mostly used for rehabilitation of disaster affected smallholders and still little seed is sold in regular markets. Improved seed was in 1996/97 only used at 2 per cent of the cereals area, mostly for wheat and maize (CSA, 1998). Fertilizer is currently imported by four companies, three private ones next to the former state monopolist Agricultural Inputs Services Corporation. After the devaluation of the Birr, a 15 per cent subsidy was introduced in 1993 to mitigate the price increase for fertilizer. The subsidy rate rose to 20 per cent in 1994 and to 30 per cent in 1995, with the subsidy amount increasing to 178 million Birr, but in 1997 the retail price of fertilizer was liberalized and the subsidy abolished.

Land in state ownership. The current constitution states that land remains in state ownership, and farmers only enjoy user rights. Land cannot be sold or mortgaged but lease arrangements of up to 15 years are allowed in some regions. New commercial farms are free to lease land provided this does not conflict with the interests of surrounding farmers and pastoralists.

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[16] The minimum capital requirement for a foreign investor investing in engineering or other technical consultancy services is 100,000 US Dollars.

[17] The Internet site of the Ethiopian Investment Authority (www.ethioinvestment.org) contains since summer 1999 information on Ethiopia’s investment regulations, on promoted projects, and investment opportunities in agriculture, manufacturing, mining and tourism.

Reform of farmers cooperatives. After 1991, many of the former compulsory cooperatives were dismantled but under the Proclamation of 1995 concerning the formation of agricultural cooperative societies, a new attempt was made to establish cooperatives, this time on a voluntary basis.

Export promotion. In 1997 Ethiopia took several initiatives to promote its exports. It became an observer at the WTO, but without applying for future membership. It also made a request for technical assistance within the Integrated Framework for Trade Related Technical Assistance for Least Developed Countries,[18] and received technical assistance since from several agencies, including WTO, to enhance its capacity to capture potential benefits arising from new trade opportunities. With support of UNCTAD, Ethiopia has also established in 1997 an Ethiopian Trade Point that distributes trade information worldwide through the Internet.[19]

3.3 Consequences of the Uruguay Round Agreements

So far, the Uruguay Round Agreements have not lead to any important changes in the external trading environment of Ethiopia. Several studies had predicted a modest price increase for wheat, ranging typically from 4 to 7 per cent, but recall from Chapter 2, Figure 2 that in effect wheat prices dropped, presumably due to the crises in Asia and Russia. As long as Ethiopia's wheat imports consist of food aid, all this has only minor effects on the domestic wheat market. For coffee, a price decrease of about one per cent was expected in one of the studies, and this would not seriously reduce export proceeds. For beef, new export opportunities might emerge in the future if the EU decides to liberalize this sector further, but Agenda 2000 offers little in this respect.

The policy adjustments implemented by the Ethiopian government since 1991, have ensured that currently most of Ethiopia's policies are compatible with the GATT rules, see Text box 3. Export subsidies were abolished, state firms have become autonomous without privileges, and import tariffs have been simplified and reduced considerably. These reforms went beyond what is minimally required according to the GATT rules for a least developed country. Hence, we can generally conclude that the GATT/WTO rules do not pose a major constraint on Ethiopia. Yet if Ethiopia chooses to join WTO in the future, it will face some restrictions regarding its support to agriculture as calculated in the Aggregate Measurement of Support (AMS). Several types of support enjoy exemption (development projects, input subsidies), or are subject to *de minimis* rules. However, highly subsidized floor prices for producers will enter Ethiopia's AMS, which is low since it mainly consisted of (modest) support to state farms in the base period. This leaves limited scope for maintaining such floor prices, as an increase in AMS is not permitted. As mentioned earlier, erosion of the AMS through domestic inflation can be avoided by notifying it in, say, euros or US dollars.

In short, the minimal financial means available to Government make it by themselves very difficult for Ethiopia to provide any support to the agricultural sector, which is therefore low by attrition rather than by design. As regards more targeted support to export oriented sectors, the Uruguay Round Agreements provide all the necessary exemptions to least developed countries,

[18] IMF, the International Trade Centre, UNCTAD, UNDP, World Bank and WTO are co-operating with the LDCs to coordinate their trade assistance programmes through an Integrated Framework for Trade Related Assistance to these countries.

[19] At its Internet sit (www.telecom.net.et/~etp) the Ethiopian Trade Point supplies information on export products, trading companies and on tourism and travel.

Text Box 3 : Evaluation of general economic policies of Ethiopia with respect to GATT/WTO rules

- Agricultural research and extension services are generally permitted as Green Box policies under the Agreement on Agriculture
- An agricultural input subsidy on for instance fertilizer is allowed for a developing country as long as the subsidy is generally available to low-income or resource-poor farmers; otherwise the subsidy has to be included in the country's AMS. The same applies to a credit subsidy for farmers, possibly implicit in the credit supply and interest rate of government controlled banks.
- Infrastructure investments for agriculture are Green Box policies; for other sectors, these investments are not explicitly considered an export subsidy.
- Export subsidies for non-agricultural commodities, as implied in the import duty drawback scheme, are allowed for a least developed country as long as it is not competitive in the export market under consideration. The same applies to export subsidies implicit in schemes for duty free imports or bonded warehouses, in credit subsidies, in tax privileges for licensed investments, and in subsidized investments in state enterprises. If export competitiveness is reached, for instance in Ethiopia for pre-tanned skins of sheep and goats, all export subsidies for these sectors have to be phased out in eight years.
- Export promotion that does not involve export subsidies is allowed. The export revenue retention regulation, in which foreign exchange earned with exports can be kept for imports, will benefit exporters, but is not considered an export subsidy, since this is common business practice elsewhere in the world.
- Privatization is not required, as ownership is of no concern to WTO, although covering losses of exporting state enterprises will be considered as subsidizing exports. An implicit land rent subsidy, when farmers pay no or a low rent for state owned land, can be considered de-coupled income support, and thus an allowed Green Box policy.
- Lowering import tariffs is welcomed by WTO rules, but not required for a least developed country.
- Abolition of export taxes and deregulation of domestic prices, trade and foreign exchange regime are not required by WTO rules, but consistent with its goal of free trade.
- Domestic indirect taxes (sales tax, excise tax, checkpoint tax) are consistent with WTO rules.

though in the future some difficulties might arise for skins, if Ethiopia becomes competitive[20] for these commodities.

3.4 Opportunities

For Ethiopia, the main challenge would presumably be to increase the volume and processing level of its exports, and this is only possible if the quality of its produce is improved. In principle, the Uruguay Round Agreements make it easier for LDCs to achieve success on this front. Through improved market access and tariffication of non-tariff barriers abroad it seeks to create possibilities for increasing the export volume. Through international standardization of quality aspects, it creates more opportunities to export those qualities that give higher revenue. Through a decrease in tariffs and thus in tariff escalation on the importer's side, it creates room for increasing the exports of processed commodities. However, how this has worked out in practice remains unclear, because of the large number of confounding factors such as the Asia crisis and El Niño, and because importers often kept their import restrictions intact. For example, for several fruits and vegetables the EU has not replaced its highly complicated import regulations by tariffs but by just a new set of import regulations, and with respect to processed goods it continues to take anti-dumping actions.

[20] According to WTO rules, a country is considered to be competitive on the export market of a product if it reaches a share of at least 3.25 percent in two consecutive calendar years. A product is here defined as a section heading of the Harmonized System, indicated by a 4-digit code.

To ease Ethiopia's supply constraints, promotion of investments in road infrastructure, agricultural extension and privatization are most important. Though average transport margins in domestic trade flows may seem relatively modest (SOW-VU, 1997a), this only reflects the lack of economic integration. The vast majority of the population is living more than half a day's walk from the nearest all-weather road. Typically, products are only being transported over short distances and only farmers who live near roads and markets do supply any product. For them, the producer price will only show minor change if new roads are constructed. It might even drop because of the competition from newly connected suppliers. As stated earlier, these investments in infrastructure are perfectly in accordance with WTO rules.

Besides infrastructure, Ethiopia will have to raise its agricultural yields. This is important both for domestic food security and for diversification of agricultural exports. Clearly, in case of Ethiopia there is no point in arguing that the country could export non-agricultural products to import food as the industrial base is so weak. Moreover, the agricultural potential is sufficiently high to opt for agricultural development as well. On field demonstration plots considerable increases in cereal yields and revenues were achieved through improved farm practices[21] which are far superior to what the farmers are commonly able to obtain. Hence, agricultural research and extension services have an important role to play. To increase their effectiveness, the relation between research and extension services needs to be intensified, and the extension services need to be expanded and organized more effectively. A rise in agricultural productivity will presumably also require expansion of credit, especially to finance the purchases of seeds and fertilizer. A special topic in this respect is that in Ethiopia land cannot be used as collateral because it is state owned. Therefore, it will be necessary to develop other forms of mortgage. Experience suggests that farmer cooperatives can be used as intermediaries and that formal land lease contracts might be used as collateral. All this is perfectly within WTO rules that permit subsidization of agricultural research and extension services and in developing countries even allow agricultural input subsidies targeted at low-income or resource-poor farmers.

[21] The Annual Report 1994 of the Sasakawa-Global 2000 project, as reported in Berhan (1996), showed that improved farm practices led to more than a doubling of wheat yield and revenue, while for maize a quadrupling was recorded.

Chapter 4

The Uruguay Round Agreements and Ethiopia: Commodity specific implications

To illustrate further how the Uruguay Round Agreements might affect Ethiopia, this chapter explores in some detail the consequences of the agreement for selected commodities that play an important role in the international trade of Ethiopia or have a clear export potential.[22] The commodities are coffee, wheat, beef and beef products, and hides and skins. The aim is to show how specific policies for these commodities relate to WTO regulations and exemptions. This naturally leads to specific topics encountered, including the existence of a Commodity Agreement for coffee, domestic price stabilization for wheat, the importance of sanitary standards for beef, and the possibility of becoming competitive for skins.

4.1 Coffee

Coffee is Ethiopia's main export crop and contributes more than sixty per cent to total export earnings. It is sold as green coffee beans, with further processing like blending, roasting and grinding taking place elsewhere. Currently, the major markets for Ethiopian coffee are the European Union (for about half of exports), East Asia (for about a quarter) and North America. It was expected that the Uruguay Round Agreements should have limited effect on the international coffee market, with a modest drop in real price of about 1.5 per cent only. Ethiopia also saw its preferential treatment vanishing in the EU, because the EU's import tariff for green coffee was reduced to zero, as was already the case in the USA. The EU lowered the import tariffs on roasted coffee and instant coffee as well, to 7.5 and 9 per cent, respectively, but Ethiopia has not benefited from these reductions since, as mentioned, its coffee exports only consist of green beans. Thus, in theory the price effect has been minor or negligible, in part because the market was already liberalized.

More important than any WTO-related effect is clearly the secular drop in coffee prices relative to non-agriculture that started around 1980, and was shown in Figure 2 of Chapter 2. Structural adjustment reforms tend to promote exports in quantity terms, and the analysis of commodity markets for small countries taken in isolation would seem to suggest an increase in monetary terms as well. However, when a large number of countries has to conform to the same policies, world prices may be affected. Of course, there are a large number of other factors contributing to a secular fall in prices. Technological progress, in combination with stagnating demand by developed countries also may force coffee price to drop, and so can specific planting decisions. Yet, it is symptomatic that even cotton whose demand worldwide is by no means satiated sees its price fall short of the overall trend.

With respect to WTO, all current domestic policies on coffee, as summarized in Table 10, are allowed under the GATT rules. We review the major ones.

[22] This chapter is based on the background reports Alemu (1996), Assefa (1996), Berhan (1996) and Merbis et al. (1997a).

Table 10. Evaluation of Ethiopia's policies related to coffee

Policy	Margin (in Birr per kg)	Compatibility with GATT/WTO rules	Promotion of exports
State owned coffee farms		Allowed	0
Extension services		Allowed	+
Supply of subsidized inputs		Allowed (DEV)	+
Infrastructure investments		Allowed (LDC)	+
Investments in hullers and washing stations		Allowed	+
Floor price washed coffee		AMS	0
Regulated domestic coffee trade		Allowed	0
Regional development tax	0.50	Allowed	-
Government coffee auction		Allowed	?
Export taxes on coffee	1.59	Allowed	-
ICA export quota		Allowed	-

GATT : DEV = special rule for developing countries ; LDC = special rule for least developed countries ; AMS = included in Aggregate Measurement of Support

Export promotion : + = positive, 0 = neutral, - = negative

Source : Merbis et al., 1997a.

State-owned coffee farms. While coffee is Ethiopia's main export crop, it is cultivated on only 3 per cent of the cropped area, see Figure 6 for the locations where coffee is growing. Production is for 95 per cent in the hands of small farmers, and large state-owned plantations supply the remainder. Ownership of farms and firms is of no concern to WTO, as long as these are financially independent of the government. Had they been subsidized, by covering losses or otherwise, these subsidies would count as agricultural producer subsidies to be included in the AMS, which by WTO rules is not allowed to rise.

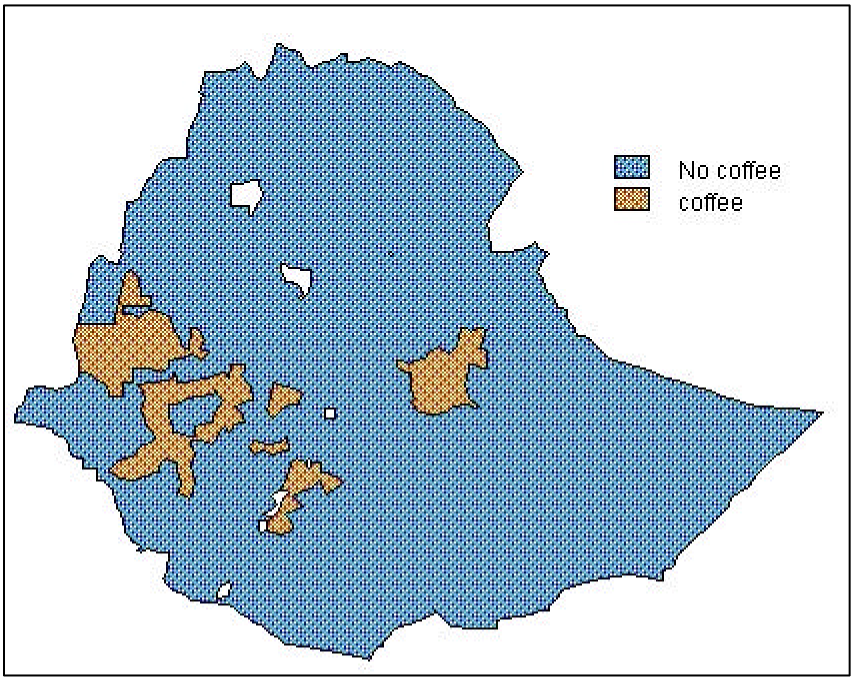

Figure 6. Ethiopia: Coffee cultivation.

Source: FAO, 1998c

Coffee Improvement Project (CIP). Small farmers who cultivate coffee do so as a cash crop in combination with food crops and allocate on average about 20 to 40 per cent of their land to it. Their cultivation practices are simple. They use little fertilizer and rarely any other chemicals, and average yield is around 600 kg per hectare. In several coffee-growing districts, the Coffee Improvement Project (CIP) stimulates cultivation and marketing of coffee, for instance by extension services, by renewing coffee bushes with improved varieties, by supplying farm inputs, and by construction of roads and warehouses. In these CIP-districts coffee yields have increased significantly, typically by 50 per cent, to about 900 kg per hectare. According to WTO rules, the Coffee Improvement Project can be considered a program to foster agricultural development and consequently, its investments and input subsidies targeted to poor farmers are exempted from the AMS-calculation.

Investments in hullers and washing stations. Primary processing of coffee takes place at or near the production location, either by sundrying or washing of the beans. For sundried coffee, the beans are picked and dried by the farmers and sold to collectors, who in turn sell them to wholesale traders. Since the quality of sundried coffee is hard to assess before hulling, farmers and collectors have to sell their coffee at prices that do not adequately reflect its quality. For washed coffee, the ripe (red) berries are picked by the farmers and sold to washing stations, which after processing (washing, drying and grading) sell the coffee beans directly to the auction. Subsidized investments in hullers and washing stations in development projects aim to stimulate primary processing, especially washing since washed coffee fetches a premium price on international markets. These subsidies are allowed for developing countries according to WTO rules.

Fixed producer price of red berries at washing stations. The Coffee and Tea Authority still fixes the prices at which the washing stations have to buy red coffee berries from the farmers, a legacy of the previous regime that nationalized all washing stations and turned them over to Farmers Co-operatives. These prices are determined on the basis of the auction prices, and leave a reasonable profit margin for the washing stations. The system is intended to strengthen the bargaining position of the farmers when selling their coffee to the washing stations. According to WTO rules, any implicit subsidies to farmers in excess of 10 per cent of the crop value are to be included in the AMS.

Regulated domestic trade in coffee. Domestic trade in coffee in Ethiopia is heavily regulated through licenses that restrict their holders to only one type of economic activity. The system is meant to avoid concentration of market power. Coffee collectors are only allowed to buy sundried coffee from farmers and to sell it to coffee wholesale traders. These are only allowed to buy sundried coffee from collectors, process it and sell it at the auction. Coffee sold at the auction is officially destined to exports, and only coffee of inferior quality is allocated to the domestic market but since about half of the produced coffee is consumed domestically, it would seem that much is being traded outside the licensed marketing channels. This type of licensing is allowed under WTO but the question remains whether it helps Ethiopia to increase its export earnings from coffee. With the current licenses, collectors and wholesale traders are restricted to sundried coffee, and this may hinder growth of washed coffee supply.

Government coffee auctions. At auctions coffee is purchased by export traders, who process it further (milling of washed parchment coffee, cleaning, selecting, grading and mixing) before selling it on the international market. At the auction, coffee grading is done in the morning, and export traders have only one hour before the auction starts to assess the quality of the coffee offered. Export traders generally consider this period too short for a proper quality assessment, which is consequently conducted after purchase. This creates a risk premium that accrues to traders, as auction prices insufficiently reflect quality. Coffee auctions are allowed under the WTO rules but in Ethiopia auction services are partly subsidized. However, as the auction costs are paid out of the export taxes on coffee, this subsidy can probably be disregarded.

Export taxes on coffee. Licensed coffee exporters are only allowed to buy coffee at the auction, process and export it. Coffee exporters have to pay several export taxes: a transaction tax, a cess tax, an export duty and the surtax on coffee. Coffee is nowadays the only commodity on which export taxes are levied and these export taxes are an important source of government income. In recent years they have accounted for about 14 per cent of the export price. This tax share fluctuates with the surtax that increases progressively with the international coffee price. Unlike subsidies, export taxes are allowed under WTO rules.

ICA coffee quota. Coffee exports from Ethiopia were restricted through the export quotas of the International Coffee Agreements. However, Ethiopia has never filled these export quotas and still has ample room for expansion. If properly registered at WTO, commodity agreements are allowed.

WTO rules and options for enhancing trade earnings from coffee. In short, all major policies are allowed under current WTO rules, but taxes on cultivation by regional government and on export by central government would seem to be at odds with the prevailing subsidies through development projects such as CIP to make coffee cultivation more attractive to farmers. Under present WTO rules, Ethiopia has various options to expand its export revenue from coffee. We mention the following:

1. Increasing coffee production through *yield increases and area expansion*. The Coffee Improvement Project could be expanded to all major coffee producing areas, and the coffee area can be increased for example on slopes. This would also help arresting erosion.
2. Increasing exports of *higher priced qualities* in general, and in particular of washed coffee, coffee by origin, and organic coffee. For this purpose, international price differences must be better transmitted to the domestic markets by promoting quality grading before sales, for instance at the coffee auctions. Higher prices for washed coffee, corresponding to the premium for washed coffee at the international markets that ranges recently from 25 to 120 per cent, will stimulate private investments in washing stations. Demand for higher quality coffee has become stronger, especially in North America, the European Union and East Asia. This opens new opportunities for Ethiopia from where all coffee varieties are supposed to have originated, and which still has a broad genetic base of the species. Several Ethiopian coffee types such as Harar, Sidamo, and Jimma coffee are already appreciated in international markets, and current trade contacts may be used to increase the sales of higher priced qualities.
3. Entering into export of *processed coffee*. Ethiopia's domestic market for coffee offers opportunities for coffee processing (roasting, mixing and grinding) enterprises that eventually can export as well. Since coffee falls under the Agreement on Agriculture, development projects that subsidize investments for coffee processing are allowed.

4.2 Wheat

Though wheat is not the major cereal grown in Ethiopia (see Table 11 and Figure 7), it deserves further discussion in this paper because it makes up for the lion share of food aid and because its scope for yield improvement is significant.

Table 11. Production of major cereals in Ethiopia during 1995-1997, in 1000 tons

Maize	2832
Teff	1720
Sorghum	1644
Wheat	1133
Barley	1020
Millet	267

Source: FAO, 1999.

Prospective studies on the anticipated consequences of the Uruguay Round Agreements on international trade showed a modest increase in international prices for cereals in general, and wheat prices in particular were expected to increase with 4 to 7 per cent (Goldin and van der Mensbrugghe, 1995; FAO, 1995c). In the mean time wheat prices have fluctuated strongly and dropped significantly after an initial increase by 50 per cent in 1995/96 (see Figure 2 in Chapter 2). As long as wheat imports are received as food aid, the world prices will have a limited impact on the Ethiopian economy. Table 12 shows that current WTO rules impose no restrictions on domestic policies for wheat.

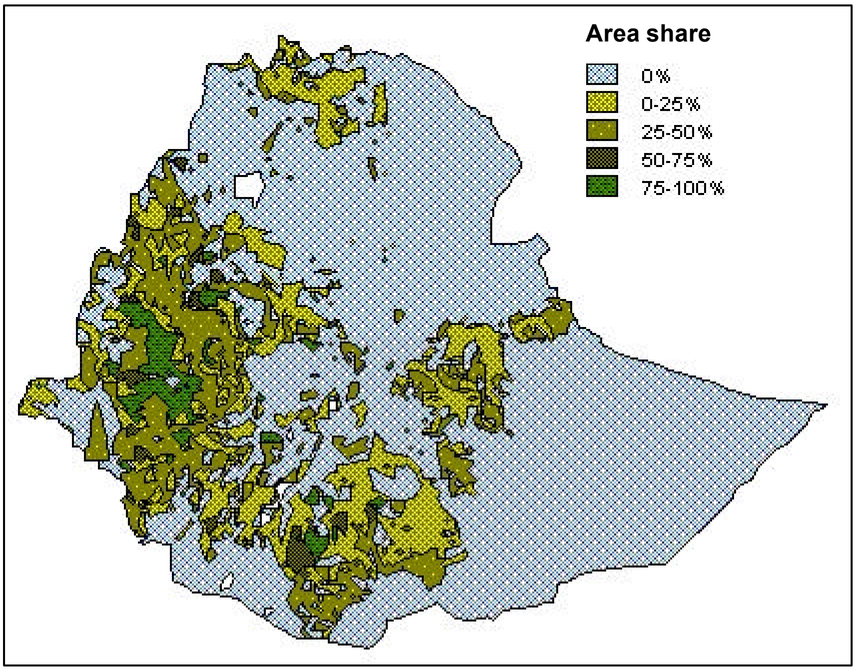

Figure 7. Ethiopia: Wheat cultivation.

Source: FAO, 1998c

Table 12. Evaluation of Ethiopia's policies related to wheat

Policy	Margin (in Birr per kg)	Compatibility with GATT/WTO rules	Promotion of exports
Extension services		Allowed	+
Supply of subsidized inputs		Allowed (DEV)	+
Local sales taxes	0.02	Allowed	-
Import tariff		No reduction (LDC)	0
Tariff exemption of aid		Allowed	0
State monopoly for aid imports		Allowed	0
Public wheat stock for food security		Allowed	0
Wheat distribution (free, Food-for-Work)	1.80	Allowed	0

GATT : DEV = special rule for developing countries ; LDC = special rule for least developed countries

Export promotion : + = positive, 0 = neutral, - = negative

Source: Merbis et al., 1997a

Extension services and supply of subsidized inputs. Most of the country's cultivated area is planted to cereals, under rainfed conditions with traditional technology and low levels of fertilizer application. Wheat is grown especially in the central highlands and its crop area share varies around 8 percent. Yields are generally low though they have risen significantly over the last decades, from 0.75 ton per hectare in the 1960's to about 1.2-1.4 tons in recent years.[23] Total wheat production is reported to have grown to around 1.1 million tons. The current low yields of cereals could be improved considerably, as witnessed by current field demonstrations in the Sasakawa-Global-2000 project and by the regular extension work of the Ministry of Agriculture. These trials with improved practices, improved seed and fertilizer show yields of 2-3 tons per hectare combined with increased net revenue. Yet in 1996 improved seeds were only used for 6 per cent of wheat area, though on 58 per cent of the land some fertilizer was already used. Although insufficient rainfall might limit the applicability of high yielding technologies in the northern parts of Ethiopia, overall there is ample room for further yield increase. Figure 8 substantiates this statement by comparing actual and potential yields. It shows that only in a few parts of the country the realized yield is above a third of its potential. The record cereal harvests of 1995 and 1996 are also indications of the growth possibilities in agriculture. The increased domestic cereal production has made Ethiopia much less dependent on imports, and food for distribution was in those years mostly purchased domestically rather than being imported, but nonetheless financed by the donor community. As mentioned earlier, agricultural extension is always allowed under WTO rules, and subsidization of agricultural inputs for poor farmers is allowed in developing countries.

Import tariffs on wheat imports, and tariff exemption for aid. Cereals imports mainly consist of wheat and wheat flour. Since the famine of 1984, the country has had a structural food deficit and significant amounts of wheat have been imported as food aid financed by international and bilateral donors such as the WFP, the USA, and the EU. The imported volume has fluctuated over the years, with a maximum of almost 1 million tons in 1992, followed by a gradual reduction to about 200 thousand tons in 1997, and again an increase in the past 2 years. Commercial imports are negligible mainly because of a 5 (formerly 30) per cent import tariff, in contrast to aid imports, which are duty free. According to the Uruguay Round Agreements, import tariffs are to

[23] However, other sources report lower wheat yields of about 1 ton per hectare along with a considerably larger area.

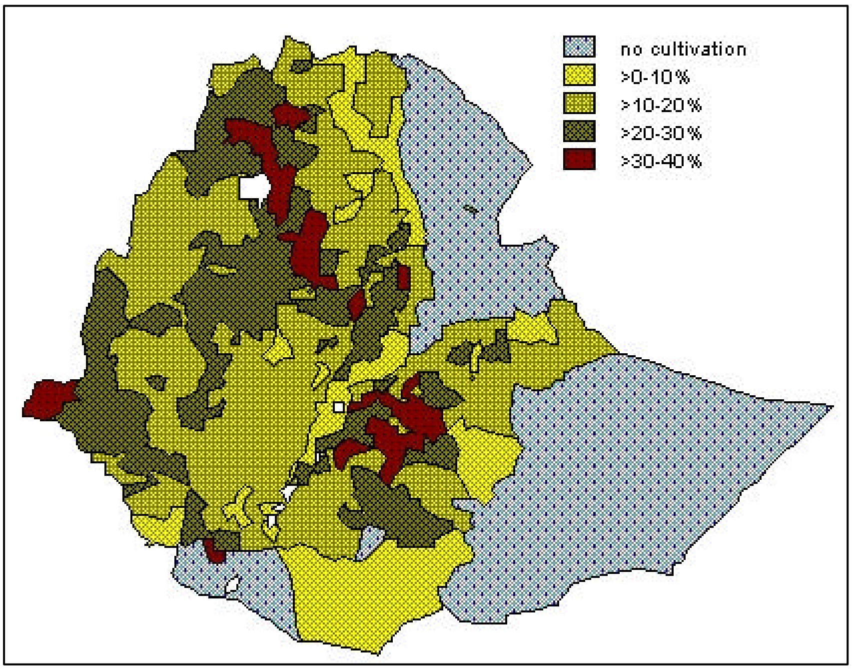

Figure 8. Ethiopia: Yield ratio (actual/potential).

Source: FAO, 1998c and this study.

be bound but the least developed countries do not have to lower their import tariffs. The exemption of aid financed imports would seem to conflict with the non-discrimination principle, but it is allowed under the GATT rules, under the presumption that food aid does not compete with commercial imports.

State monopoly on food aid imports. While non-discrimination rules do not apply to food aid, Ethiopia has a state monopoly on imports as an additional device to protect it from foreign complaints to that effect. The state owned Ethiopian Grain Trading Enterprise handles all wheat aid imports. As import monopolies are not forbidden by the Uruguay Round Agreements, the rule prohibiting discrimination between domestic production and foreign producers can be circumvented by letting the state-monopoly set the terms for domestic producers and consumers through its profit and cost margins that effectively act as import tariffs.

Public wheat stock for food security, and wheat distribution. Imports of wheat are mainly distributed as domestic food aid. Refugees receive the aid without charge but an increasing share is paid out as wages in food-for-work schemes. Food aid is also used to build up food reserve stocks or is sold in the market to meet the costs of the food distribution programs, and both uses are explicitly allowed under WTO rules.

Stabilization of the domestic wheat price. Ethiopia sees food price stability as one of its important policy priorities, and adjusts its requests for food aid and its stock levels accordingly. Although the Uruguay Round Agreements tolerate buffer stock operations for definite food security purpose (see GATT, 1994, p.58), their use as price stabilization device is questionable, because domestic price fluctuations are not always harmful and because buffer stocks may not offer the most appropriate instrument to mitigate these fluctuations. Regarding the necessity, the origin of the instability matters. Fluctuations in domestic prices can originate from the world market or from the variability of domestic production. If domestic variability is the source, price fluctuations help stabilizing the income of farmers, but at the same time may hurt or benefit other population groups. Increased producer prices spread the burden of a crop failure over producers and consumers; a stable producer price would shift all the risk to the farmer and the resulting income decrease may even prevent purchase of inputs for the next harvest. Through lower prices part of the benefits of a bumper crop are passed on to the consumers. Moreover, private trading and stockholding can only function commercially as long as prices are allowed to increase after the harvest to cover costs of stockholding. Therefore, it is harmful to eliminate all price fluctuations from domestic origin through some stabilization mechanism. Only extreme fluctuations may require dampening. As regards fluctuation on the world market the argument is more indirect, but here also individual agents can in principle make their choices more efficiently if they are faced with undistorted prices. Borrowing and income transfers are preferable to price controls. The main arguments for avoiding food price fluctuations are that the poor will find it difficult to borrow or buy insurance, and that extreme price volatility should be avoided because even the rich cannot cope with it and macro-economic instability results. For the poor, food-for-work programs can give adequate coverage but the argument against extreme volatility remains valid.

Extreme fluctuations of domestic origin can be contained through free international trade. Private traders can cover their risks through future contracts on the world cereal market and the fact that Ethiopian private traders are currently not involved in international wheat trade prevents them from gaining experience in this respect. Clearly, in a landlocked country with poor infrastructure like Ethiopia food security cannot be guaranteed without a dense net of small local emergency stocks but it will often be easier to ship goods from a harbor to specific domestic locations, than from one local warehouse to some distant region. Hence, it may be preferable for the government to hold some financial stock of foreign exchange than large cereal stocks. Moreover, these financial resources can also be used to purchase on the domestic wheat market if there are surpluses in some regions. In contrast, public buffer stocks tend to crowd out private trade and stockholding. Furthermore, their use is restricted by both the warehouse capacity available and the financial means of the buffer stock agency and when these restrictions can become effective, buffer stocks tend to elicit speculative trade. For these reasons, buffer stock agencies have often incurred large losses, only adding to the fiscal deficit.

The effect of price fluctuations on the world market can be reduced by temporarily disconnecting the domestic market from the world market, either by controlling the import or export volumes directly or by flexible tariffs that dampen the price fluctuation. The surtax on coffee is used for similar purposes. The WTO accepts direct control of trade flows through a government monopoly on imports or exports, as discussed above and variable export tariffs are also allowed under the GATT rules. Extremely high international prices that threaten to increase the domestic price through exports can thus be counteracted by variable export tariffs. In contrast, import tariffs must remain within their bounds and variable levies are explicitly forbidden in the GATT rules. To prevent the country from being flooded by cheap imports safeguard mechanisms can be activated, that will dampen the domestic price decrease. These mechanisms are defined by the GATT[24] and can only be invoked when mentioned in the country's Schedule of Concessions, by adding the code SSG ("Special Safeguard Guarantee") in the tariff line of the tariffied product. Then two options are open. In the quantity triggered form of the SSG an additional duty can be imposed if imports exceed their average "during the three preceding years for which data are available" by no more that five per cent. So a relatively small annual rate of import growth may suffice to trigger this provision, and the maximum additional duty may be as high as a third of the ordinary duty. Under the price triggered form of the SSG, an additional duty can be imposed if the c.i.f. import price of the shipment concerned falls below 90 per cent of the trigger price (which is the 1986-88 average reference price). The duty rises when the c.i.f. price falls deeper. The EU and the US have declared high trigger prices for many products and the EU has indeed already invoked the SSG for poultry meat and sugar.

4.3 Beef and beef products

For international trade in beef and beef products, sanitary measures are of great importance. The Uruguay Round Agreements contain a separate provision to arrive at international minimum sanitary standards, to which countries can add their own measures provided these can be supported by clear scientific evidence but this process is far from being completed. Currently, every importing country can still have its own set of sanitary measures and apply these to its imports to protect its consumers and producers. For example, the EU forbids the use of growth hormones while the USA and other countries ban the import of meat from regions where foot-and-mouth-disease is endemic and require that the whole region should be free of the disease, without vaccination. Developing countries in South America can possibly conform to the strict rules of the USA and enter this premium segment of the world beef market, but a least developed country like Ethiopia cannot hope to meet these sanitary requirements in the foreseeable future.

As for other agricultural products, world market prices of beef have dropped significantly, although prospective studies had expected a small to moderate increase. The fall by a quarter since 1994 also reflects the persistence of surplus disposals. These occurred as a consequence of a contracting demand following the BSE crisis in Europe, the economic crises in Asia and Russia, and the continued bans in the EU on beef from the USA in relation to the hormone dispute.

All current policies of Ethiopia with respect to beef and beef products, as shown in Table 13, are allowed under the WTO rules. These policies will be briefly discussed below.

[24] Konandreas and Greenfield (1996) suggest that a country may have own safeguard mechanisms with import tariffs along a sliding scale, that dampen price fluctuations more than the GATT safeguards. They argue "that the legality of a price band is not entirely clear [....], the extent to which price bands may be challenged formally at the WTO is likely to depend on the predictability and transparency of their implementation." No GATT jurisprudence exists yet on this topic.

Table 13. Evaluation of Ethiopia's policies related to beef and beef products

Policy	Margin (in Birr per kg)	Compatibility with GATT/WTO rules	Promotion of exports
Livestock extension services		Allowed	+
Livestock health services		Allowed	+
Infrastructure investments		Allowed	+
Market tax	0.02	Allowed	0
Checkpoint tax	0.30	Allowed	-
Investments in feedlots and fattening schemes		Allowed (DEV)	+
Investment in livestock trucks		Allowed (DEV)	+
Fees for export services	0.17	Allowed	0
Implementation of sanitary standards		Allowed	+

GATT : DEV = special rule for developing countries ; LDC = special rule for least developed countries

Export promotion : + = positive, 0 = neutral, - = negative

Source : Merbis et al., 1997a

Livestock development projects. Ethiopia has large livestock herds. Its cattle stock is currently estimated at about 30 million. However, many animals suffer from endemic diseases. Rangelands often suffer from overgrazing and hence from erosion. Three-quarters of the cattle are probably kept in the highlands as part of a mixed farming system. The average household only possesses a small number of animals that are primarily held for their draught power and for the calves and in the second place for meat, milk and manure. Animals are only slaughtered when old, and beef can thus be considered a by-product. In the lowlands of Ethiopia livestock production takes place on natural pastures by pastoralists. Herding is their main activity and income source. The stock is mainly kept for subsistence and their productivity is low. Several projects have been targeted to the livestock sector, especially in the rangelands, and aimed to increase the quality of livestock products and to improve the marketing structures. They included extension services, health services, infrastructure investments, which are Green Box policies under WTO rules, and investments in feedlots, fattening schemes and livestock trucks which are allowed for developing countries.

WTO rules and options for enhancing trade earnings from beef and beef products. To utilize its potential in beef exports, Ethiopia needs to raise the volume and quality of its domestic beef production. It is presumably premature to target for countrywide implementation of international sanitary standards. An export strategy might start with exports from a well-defined, tightly controlled area. According to WTO rules, actual exports of beef have to be negotiated bilaterally and satisfy the sanitary requirements of the importing country. Ethiopia could try to acquire from the EU a 'minimum access' import quotum with reduced import tariff, as several other African countries have.

In the short term the opportunities for beef exports are very limited, also because of the poor condition of processing plants. Until their recent privatization, the meat plants investigated for this study showed similar characteristics. They were old and in need of renovation, they produced at low capacity several products for the domestic market, and they discharged their effluent partly or completely into the environment. They did not have an active export marketing strategy, nor an active cattle purchase or supply policy, despite the many diseases of the slaughtered animals. The production of beef products such as corned beef and beef-in-jelly proved value reducing rather than value adding and while exports of chilled or frozen beef carcass would seem possible, domestic use has been more profitable.

4.4 Hides and skins

With its large herds of cattle, sheep and goats, Ethiopia is a natural exporter of hides and skins, which constitute the second largest export item, accounting for about 10-13 per cent of export revenue in recent decades. Two thirds originate from sheepskins. Goat skins contribute slightly more than one sixth, and cattle hides slightly less. The EU is the major market for cattle hides and goats skins and buys about 90 per cent of their exports. For sheep skins the destinations are more diverse. The GATT requirement of an import tariff reduction for industrial commodities made it easier to export leather and leather goods. In the future, new opportunities for exports might open up for developing countries, because the decrease of agricultural support in the developed countries could cause a fall in the number of cattle and hence in the supply of hides.

WTO applies two sets of rules for hides and skins. Untanned hides and skins are covered by the rules for agricultural products. Pre-tanned hides and skins and their derived products are not considered agricultural and are subject to the stricter general rules of GATT. For instance, least developed countries also have to phase out export subsidies (over a period of eight years) once they reach export competitiveness in the market of a non-agricultural product (GATT 1994, Agreement in Subsidies and Countervailing Measures, Article 27). Ethiopia mainly exports its hides and skins in semi-processed form, and its finished products are largely for the domestic market. All current policies on hides and skins as listed in Table 14 are allowed under the GATT rules.

Table 14. Evaluation of Ethiopia's policies on hides and skins

Policy	Margin (in Birr per kg)	Compatibility with GATT/WTO rules	Promotion of exports
Checkpoint tax	0.74	Allowed	-
Implementation of quality standards		Allowed	+
Investments in processing raw hides and skins		allowed (DEV)	+
State owned tanneries	17.68	allowed	0
Fees for export services	0.69	allowed	0

GATT : DEV = special rule for developing countries ; LDC = special rule for least developed countries

Export promotion: + = positive, 0 = neutral, - = negative

Source: Merbis et al., 1997a

Investment in processing of raw hides and skins and implementation of quality standards. The livestock resources of Ethiopia are large but raw hides and skins are of low quality. Next to 30 million cattle, there are about 22 million sheep, 17 million goats, numerous horses, donkeys, camels, etc. Hides and skins are only by-products relative to meat and the supply of hides and skins is not very responsive to the prices offered. The curing of fresh hides and skins is rarely appropriate, due to lack of facilities at slaughtering and insufficient price incentives. When raw hides and skins are sold to the tanneries, hardly any grading takes place and more or less fixed prices are paid by weight, not by quality grade. Tanneries complain that most raw material is not of acceptable quality due to poor animal husbandry, insufficient slaughterhouses, parasite damage and low level of pre-processing technology. One of the major tanneries reported in 1998 that *"20* *per cent of the skins and hides supplied to the factory is turned down because of external effects caused by diseases. Another 30 per cent is simply unacceptable due to negligent and improper methods of shearing (Addis Tribune at Internet, 20-2-1998)."* Several projects have in the past invested in local processing capacity for raw hides and skins, and in the introduction of quality standards, which are all acceptable under the Uruguay Round Agreements.

State owned tanneries. Hides and skins must undergo several stages of processing before they can be used. The tannery industry in Ethiopia consists of several state-owned firms, with about 80 per cent of the capacity, and three private firms. The processing of hides and skins is a profitable activity. State owned tanneries make considerable contributions to the state coffers: a profit tax of 40 per cent plus additional dividend payments. Since no subsidies are involved, state ownership is compatible with WTO rules.

WTO rules and options for enhancing trade earnings from hides and skins. For cattle hides Ethiopia only has a small share of the international market but for sheep and goats skins its position is stronger, and even reaches 5-10 per cent for untanned sheep skins. Consequently, if Ethiopia upgrades its exported sheepskins to pre-tanned level, it may easily surpass the market share of 3.25 that gives it competitiveness in this export market. Ethiopia's share in the world market for pre-tanned goat skins barely falls below that level and a serious increase in goat skins exports could thus make Ethiopia competitive for this product as well.

In the future it may be possible to increase export earnings from hides and skins by improving the quality of current raw material and by increased processing. For this, tanneries should pay according to quality rather than by weight, and the privatization of the existing state owned tanneries could through competition operate in this direction. Once this grading is effectuated it will also become more rewarding to invest in conservation of raw hides in slaughterhouses.

In addition, export earnings can be enhanced if hides and skins are exported in more processed form. For this purpose, the tanneries would have to invest in machinery and in skills. The tanneries seem to be sufficiently profitable to finance this out of retained earnings. To develop its tanneries, Ethiopia could consider forming joint ventures with leather firms from developed countries, for example from the EU. Although tanneries are reserved for domestic investors according to the investment regulations, joint ventures with foreign investors are allowed for enterprises with highly processed end products like leather goods. The foreign partners could contribute the product design, the technology, the quality control and the market access, as well as the experience in managing the herds upstream so as to guarantee good quality hides.

Chapter 5

Unfinished business

The new round of multilateral negotiations is likely to define its own agenda and yet, so much remains to be done to implement effectively the mechanisms that were defined in 1994. This chapter considers three problems that need to be addressed: the special and differential treatment of developing countries, the access to agricultural markets of the EU and other developed countries, and the access to courts where trade disputes can be settled.

5.1 Special and differential treatment

The GATT treaty (part IV) offers special and differential treatment to developing countries. This mainly amounts to trade preferences, exemptions and temporary waivers. However, the preferences were gradually eroded through the liberalization process itself, since, by the reduction of the import tariffs in OECD countries, the value of the trade preferences diminished as well[25]. Developing countries have been asking for compensation of these losses but so far without success.

In addition, a Ministerial Decision signed in Marrakech in 1994 promised a compensation for least developed food importing countries in case the world market prices would rise as anticipated. As could be seen from Figure 2 in Chapter 2, the rise that eventually took place in 1995/'96 was very temporary, and world prices have been very low since. In hindsight one may therefore argue that there was no need to provide such compensation. However, LDCs complain that the fall in prices from 1997 onwards could not be anticipated in 1995/'96 and that no serious attempt was made to implement the promises in this Decision at the time. This lack of follow up will presumably reduce the credibility of aid promises to be made in the next round. To restore credibility of solutions that involve side payments, the WTO will have to formalize the treatment of commitments, and deal with them like any other part of the agreement, with exhaustive schedules and notifications.

5.2 Access to markets of the EU and other developed countries

As mentioned earlier, the Agreement on Agriculture only puts the machinery in place but hardly led to any improvement in market access. The EU's Common Agricultural Policy (CAP) is a case in point, and an important one since for many countries in Africa, including Ethiopia, the EU is the main trading partner. Most of these countries will not be able to expand their agricultural exports unless the EU improves the access to its markets. For this reason, the present section elaborates in some detail on the present status of the CAP and the prospects for its reform in the future. Obviously, a simple view at such reform would advocate straightforward abolition. Indeed, the CAP has had its fierce opponents ever since its first inception but despite all the transformations undergone since the early 'sixties, it lived through the attacks with singular resilience (see Ritson and Harvey, 1997). Therefore, we will go at some length describing

[25] Note that in times of low world market prices, as now is the case for sugar, the value of preferences can increase substantially.

reforms that can offer scope for compromise and strike a balance between the interests of developing countries and those of European farmers. We will indicate how the multi-functionality approach which offers separate rewards for all services rendered by farmers allows to promote trade liberalization. And, we will single out sugar, the most protected crop by far, and suggest ways to improve access without eradicating the crop.

CAP reform in Agenda 2000

The CAP underwent significant reform in 1992, as the European Commission moved its agricultural policy into a new direction. The thrust of this reform was a shift from price to direct income support, achieved by lowering the intervention prices, while compensating farmers via area and headage premiums. As a means to reduce the production of cereals and oilseeds, a set-aside scheme was introduced, and professional farmers were only eligible for compensation payments if they participated by keeping a specified fraction of their land fallow. With the benefit of hindsight, it can be concluded that the measures relieved international tensions on agricultural export markets, and virtually saved the Uruguay Round, see GATT (1994).

The CAP essentially remained unchanged since, though pressures for further reform have been building up. In its Agenda 2000, and as part of a broad package to prepare the European Union for the next century (CEC, 1997a,b), the European Commission argues that both a deepening and widening of the 1992 reform is called for. This is needed in view of developments within the agricultural sector itself, the upcoming international trade negotiations under the WTO and the planned accession of Central and Eastern European countries (CEC, 1998b). The agricultural chapter of Agenda 2000 contains a first version that was subsequently elaborated upon in the draft regulations published in March 1998 (CEC, 1998a), and after modifications was accepted in March 1999 by the European Council in Berlin (CEC, 1999).

Agenda 2000 extends the 1992 reform. The internal prices of wheat, coarse grains, beef and dairy products are reduced, while production quotas for milk are slightly relaxed. Compensation is maintained through premiums that are not fully decoupled,[26] the restrictions on the import side are preserved which for most products mean that imports are only possible within strictly specified tariff quotas, and the sugar sector stays clear of any reform. In addition, food quality and safety concerns figure more prominently, in response to outbreaks of animal diseases, and rural policies are to be strengthened (see also CEC, 1997d). It is noteworthy that the Commission has opted for such an extrapolative approach, rather than presenting a clear vision of the future of European agriculture, presumably because the views regarding agriculture appear to diverge strongly among EU member states. Whereas the original proposals by the Commission included somewhat stronger price cuts, the eventual decision was much weaker and postponed many of these changes, some until 2005. The current low world market prices for cereals, especially wheat (see Chapter 2, Figure 2) prevent exports of cereals without subsidies. Hence, to fulfil existing GATT commitments with respect to the reduction of subsidized cereal exports, the EU eventually decided to give up its original intentions of bringing its intervention prices for cereals to world market level and its set-aside rate to zero. Currently, with set-aside rates at around ten per cent and ample voluntary set asides, the EU is barely able to stabilize its exports

[26] Area premiums are linked to the production of cereals and oilseeds while headage premiums obviously relate to animal herds.

around the allowed ceilings and this rate will be maintained.[27] (see CEC, 1998c, Keyzer and Merbis, 1998, 1999 forthcoming).

As far as developing countries are concerned, Agenda 2000 leaves the import regime of the CAP as it was, and the changes on the export side are so small and gradual that the effects on world markets are probably minor. This is not likely to satisfy the other negotiating partners within the WTO. The Agenda 2000 reform leaves many pressing issues unsettled. We mention a few.

Import access. Agenda 2000 focuses on further reduction of export subsidies and keeps the import regimes unchanged. Export subsidies are mainly a concern of the EU itself due to the budgetary cost, as well as of major competing exporters such as the USA or Brazil, and much less of smaller players. As consumer demand in the EU has been almost stagnant for several years, large exporters find it more important to challenge the EU on international markets than domestically. Therefore, they generally exercise more pressure to obtain reductions in export subsidies than to acquire increased access to the EU itself. Yet several smaller players, particularly from the developing world, would gain from improved access, especially for fruits, vegetables, and possibly sugar. At present the EU implements market access commitments via tariff quotas, the modalities of which were agreed in the Uruguay Round Agreements. This is a cumbersome procedure that is discriminating among exporters, and in need of improvement. Yet the official EU's current external policy, formally not part of the CAP, is to grant country groupings preferential access through special agreements, which should ultimately be arranged in a fully WTO compatible way. This may take ten years or longer, and meanwhile discriminatory practices will prevail.

Price transmission. The European Commission continues to view price stabilization on the internal market as an important policy objective, and proposes to maintain the present system of protection through variable import tariffs and tariff quotas. Thus the EU wheat price basically follows the internal intervention price, and is unrelated to fluctuations on the world market. Similarly, the internal price of animal feed grains will not rise when there is a shortage outside the EU. This lack of transmission intensifies the price fluctuations on the world cereals market and shifts the full burden of short-term adjustment to traders and consumers outside the EU. Price transmission on the EU market would reduce these fluctuations and improve world market integration, and thus strengthen the signaling role of prices as scarcity indicators. It would also remove the artifact that the EU keeps prices of wheat and feed grains at the same level, while at world markets they are moving in parallel at a distance of 30-50 US-dollar per ton. In view of the strong volatility recently witnessed in major commodity markets, an EU contribution to stabilize these markets through better price transmission regimes would be helpful, especially for the food importing developing countries.

Acceptability of Blue Box measures under WTO. The introduction of the so-called Blue Box was a novelty of the Uruguay Round Agreements. The box "contains" measures of support that are acceptable under the agreement although they are not fully decoupled (decoupled measures are supposed to have no effect on production decisions and hence on trade: for example R&D and

[27] To avoid budgetary overruns, the farmers now only receive partial compensation for the reduction in intervention prices, also because of the experience that market prices do not immediately follow the reductions in intervention prices. The 1992 Reform assumed that they would follow in full, but this led to overcompensation, partly because of the high world prices in 1995/'96. If the current, low world prices persist, market prices might well drop to the intervention level in the future.

extension services qualify as such). The Blue Box covers among others the deficiency payments in the US and the premiums per hectare and per head of the EU. Since 1994 the US have on several occasions paid income transfers whose qualification as decoupled support is debatable. It is uncertain whether such exceptions will be made in the coming round. By harmonizing the area premiums for arable crops under Agenda 2000, the EU evidently hopes that the measures will qualify for the Green Box, or allow for the Blue box to be maintained. If the EU insists on renewal of the Blue Box, which seems inevitable, this may very well cause the next round to stall.

CEEC accession. The price reductions of Agenda 2000 reduce the price gap between the EU and the Central and Eastern European countries (CEC, 1998b). Though their accession is facilitated, it will nonetheless be a major and costly operation, as CEECs will receive substantial funds from EU's structural programs. And if the CAP remains intact, the outlays on area and headage premiums will be significant as well (Josling et al., 1998). Hence, a transitional regime is likely to be negotiated to mitigate the budgetary consequences. More important from the perspective of developing countries is that the EU's preoccupation with the accession will distract its attention from developmental efforts and from trade agreements with other parts of the world. In terms of the WTO commitments on reduction of subsidized exports, the accession offers special advantages to the EU in the short run, because it can sell some of its surpluses on these markets. In the medium term CEEC output will presumably expand as their farms acquire better access to credit and farmers from the present EU-15 may decide to expand in the CEECs where land prices are low. Consequently, the enlarged EU will remain an important exporter of temperate agricultural products, and seemingly has little incentive to increase the access for developing countries.

However, precisely because the CAP has changed so little, it is unlikely to sail unscathed through the upcoming WTO negotiations. The steps in Agenda 2000 follow logically from the earlier reform, but they actually strengthen the inherent contradictions of the system. Their contribution to trade liberalization will not appease the negotiating partners of the coming WTO round, and the planned accession of countries from Central and Eastern Europe will only make it more difficult to finance the CAP.

Outside the EU, the holders of preferences under the Lomé treaty, and the recipients of food aid are presumably the only protagonists of the CAP. As mentioned earlier, advocates of radical liberalization and elimination of the CAP are unlikely to be more successful this time than they were over the past thirty years. It would seem more fruitful to spend the efforts during the upcoming round on defining areas of possible compromise that would benefit developing countries. We discuss two, possibly complementary options: the application of the multi-functionality concept, and the reduction of production quotas on sugar beet.

Multi-functionality

The tendency in Agenda 2000 towards further decoupling of support to farmers creates additional strains on the EU budget, especially in the wake of the accession of new members. The annual agricultural budget (around 40 billion euro) still comprises half of the total EU budget, and it will increase by more than 10 per cent once the new proposals are implemented in full. Furthermore, if world prices remain as low as in 1998 or 1999, there will be an additional 2-3 billion to be spent on export subsidies. Not surprisingly, ministers of finance of EU member states often call for stabilization of the agricultural budget at pre-reform level, and it seems unlikely that EU consumers will be willing to continue paying these vast sums indefinitely.

It seems inevitable that the CAP will have to proceed towards further trade liberalization and decoupling of support. The CAP will have to substitute the publicly funded farm income support by rewards for services for which the consumer can pay indirectly, through the price of labeled products that meet consumer concerns, or directly, through entrance fees in parks, or as tax payers, via a contribution to landscape preservation. At the same time, farmers will have to pay for environmental damages caused. In such a setting, the countryside becomes much more than a producer of raw materials, and offers a variety of alternatives to agricultural employment. This asks for a re-assessment of the system of area and headage premiums the CAP currently is handing out as well as of the environmental constraints, say, with respect to manure, that are being imposed.

Within this perspective, the premiums become rewards for services that are linked to the mode of production of the farm. In this way, production characteristics such as animal welfare and preservation of rural life and natural amenities can receive their remuneration. This goes beyond the "cross-compliance" requirements proposed in Agenda 2000 (according to which farmers also comply with environmental objectives in return for payments received, see CEC, 1998a) and calls for explicit and independent assessments of the contributions made and the damages caused by a given farm operation. Like for restaurants, assessors could provide grades to farms, which the processing industry can subsequently report on its labels. While it should be acknowledged that the attractiveness for tourism differs strongly across regions, the system can also benefit areas that are less favored in terms of productivity and landscape. In highly productive areas, the relevant issue is more to guarantee that environmental standards, say, regarding the pollution of groundwater, are being respected than to generate additional income from tourism. Other, less attractive areas are highly urbanized already. There the challenge will often be to distribute fairly the gains from appreciation of land values. This leaves the regions of moderate to low productivity, of low population density and limited attractiveness. These will require investments to maintain sufficient social infrastructure (roads, schools, and hospitals in remote areas), possibly supplemented by retirement aid to farmers who cannot find a successor. Clearly multi-functionality is not a panacea that relieves the EU and national government from its responsibilities for maintaining viable conditions in rural areas. Nonetheless, by seeing to it that every region capable of earning sufficient revenue from the market no longer relies on government support, more funds are left for the less favored regions. The approach also allows to reward more directly the rural amenities that are being appreciated most highly, and since these proceeds do not fall with increased imports, it reduces the farmers' vulnerability to foreign competition. Most importantly, since multi-functionality payments can be viewed as a regular reward for services delivered, they should qualify relatively easily as Green Box measures. And if they are effectuated, the system can yield income to the farmers in EU and other OECD countries, reduce their dependence on price support and soften their opposition to further trade liberalization.

Reduction of sugar quotas

So far, the European sugar sector has managed to stay clear of all previous reforms of the CAP. Sugar prices have even risen in nominal terms since the early eighties and are in 1999 still at 98 per cent of their 1987 level, while other crops had to endure severe price cuts that were only in part compensated by area premiums. One of the outstanding peculiarities of this sector is its discontinuity in supply response, which is mainly due to the lumpiness of sugar factories and the technical impossibility of transporting sugar beets over longer distances. Sugar prices can fluctuate relatively widely until they trigger a supply reaction but when they do the reaction is dramatic. As these characteristics apply to all sugar beet production and largely to sugarcane as well, most countries tend to regulate their sugar markets relatively tightly (FAO, 1998a). Developing countries are no exception.

The CAP effectuates its sugar policy through a quota-system for sugar beet production, combined with a prohibitive tariff on non-preferential imports of refined (white) and raw sugar. All sugar imports originate from the Lomé countries (and India) which enjoy preferential (almost tariff free) access to the EU and thus depend on the CAP for their revenue. The distribution of quotas among ACP-countries is highly skewed in favor of Mauritius and Fiji, as can be seen from Table 15.

Table 15. ACP preferential sugar import quotas in white sugar equivalents and revenues, 1995/'96

ACP country	Sugar quotas (1000 ton)	Value of sugar quotas (mln euro)	Per capita value of quotas (euro)
Barbados	50.3	17.1	64.2
Belize	40.3	13.7	63.4
Fiji	165.3	56.1	72.4
Guyana	159.4	54.1	56.0
Jamaica	118.7	40.3	16.1
Malawi	20.8	7.1	0.7
Mauritius	491.0	166.7	151.6
St Christopher and Nevis	15.6	5.3	129.2
Swaziland	117.8	40.0	44.4
Tobago	43.8	14.9	11.4
Zimbabwe	30.2	10.3	0.9
Congo	10.2	3.5	1.3
Côte d'Ivoire	10.2	3.5	0.2
Madagascar	10.8	3.7	0.3
Tanzania	10.2	3.5	0.1
India	10.0	3.4	---
Total	1304.6	443.0	5.1

Source: Agra-Europe for quotas and World Bank (1998b) for population data.

Note: Only the duty free import quotas are presented here. Level of quotas and the guaranteed import price hold from 1995 until to date (India is excluded from per capita figures). The value of the quotas is measured as the difference between the EU intervention price (646.5 euro/ton) and the white sugar world market price (306.9 euro/ton) times the sugar quotas, using 1995/'96 price data.

To regulate the domestic market, the European Commission specifies an intervention price for white sugar and, based on the former, a basic price for sugar beets. Processing factories in member states are assigned A- and B-quota for which they should pay farmers at least a specified minimum price.[28] For the European Union as a whole, the total of A- and B-quotas and ACP-imports exceeds EU consumption and the surplus is exported with subsidy. Quota free C-sugar is also sold on the world market but without subsidy. The Commission pays the difference between the world market price and the intervention price and subsequently charges the sugar industry for these export refunds (except for the re-export of sugar from ACP-countries which is paid from aid and the C-sugar which receives no subsidy). Thus, the system is self-financing with respect to export refunds. The necessary proceeds are collected through a producer levy. After deduction of

[28] For A-beets this minimum price is 98 per cent of the basic price and the minimum price for B-beets is 60.5 per cent of the basic price. In Belgium, Ireland, Italy, the Netherlands, and Spain producers receive an average price for their sugar, whatever their A-, B-quotas, or possible production in excess of these quotas (C-sugar). Producers in other countries receive a different price for the three types of sugar. Therefore, the marginal return to the farmer varies considerably across member states.

this levy, the sugar factories generally keep about forty per cent of the remaining production value, and channel about sixty per cent to the farmers.

A reform of the sugar regime would start with a reduction of the intervention price. This reduction would be transmitted to factories and, through these, to the farmer. The self-financing nature of the regime has some cushioning effects, since the price reduction will also lead to a reduction in export subsidies, and hence in producer levies. More importantly, under a price reform, several sugar factories in the EU are likely to face bankruptcy, and consequently, output will be reduced, as sugar will no longer be produced in the region around these factories.

Hence, a possible reform could operate along two lines. The first would be to reduce the CAP price and let the sector itself absorb the shock. Some factories would go out of business and consequently sugar output and EU exports would drop. But it would take a severe price cut until the EU becomes a net importer. The second line of reform would be to abstain from any severe price cut and only reduce the production quotas. This would still leave the allocation of the remaining production quotas among EU-members to be decided upon, and as an alternative to a discretionary assignment the factories could auction the quotas among themselves. This could be combined with an increase in the volume of preferential imports, which themselves leave a choice between allocation of fixed import quotas to beneficiaries (ACP-countries or others) and organizing an auction whose proceeds could be earmarked for development assistance.

To highlight the possibly significant implications of such alternatives, we conducted a simple numerical exercise. Based on quantity and price data for 1996/'97, Table 16 shows how different reforms might affect the sugar exports of ACP-countries. The table distinguishes a base case and three variants. The first variant reduces the CAP intervention price by a modest 10 per cent, but cuts into the EU production quotas so as to eliminate all subsidized exports. The second variant, "Improved Access", goes one step further with quota reduction until it reaches 70 per cent of domestic utilization. ACP countries are given the opportunity to supply the shortfall on preferential terms. The third variant, "Full liberalization", combines the quota reduction with a 40 per cent reduction in the CAP price. This leads to a 250 per cent increase in imports. Clearly the white sugar price reductions affect the sugar beet price as well; since the net revenue per hectare of sugar beet is on average twice as high as that of cereals and oilseeds, a substantial price reduction will not make beet production disappear. Yet, since net revenues per hectare of sugar beet differ widely over member states, pressure is building up to reallocate the quotas over member states.

Table 16. Sugar reform scenarios, EU-15

Value account	Sugar production (mln euro)	ACP preferences, net (mln euro)	Sugar production, variant / status quo (%)	ACP preferences, variant / status quo, net (%)
Status quo	9035	514	--	--
Autarky	6939	404	-23	-21
Improved access	5110	1010	-43	+96
Full liberalization	3520	184	-61	-64

Note: net ACP preferences are computed as the difference between ACP sugar imports valued at intervention price and valued at world market price. *Status quo:* Intervention price white sugar: 646.5 euro/t, world price 344 euro/t, producer levies per unit 77 euro/t, Total sugar production 16.8 mln t, ACP imports 1.7 mln t, other imports 0.4 mln t, domestic utilization 12.8 mln t. Data are based on 1996/97 figures. ACP imports consists of duty free imports as in Table 15 and the special Preferential Sugar imports of 0.4 mln t which enter with a reduced duty. *Autarky:* Intervention price –10%; sugar production –25%, ACP imports unchanged. *Improved access:* Intervention price –10%; sugar production –46%, ACP imports +250%. *Full liberalization:* Intervention price –40%, sugar production –46%, ACP imports +250%.

The exercise suggests that sugar production quotas must be reduced significantly before any room is created for additional imports. In the improved access variant the ACP-countries enjoy substantially larger preferences in volume terms, and since the white sugar price falls only slightly, their sugar preferences double in value.

The discussion is illustrative of some basic dilemmas of trade liberalization. Radical measures would wipe out a large fraction of sugar production in the EU and would open markets for exports by developing countries, most likely by efficient producers such as Brazil and Thailand. Trade preferences would lose all their value and cause important adjustment problems in some of the ACP-countries. Hence, this option is unlikely to pass. The alternative of extending the preferential system admittedly generates new distortions in specialization in developing countries and creates dependence on the EU. Similarly, auctioning the import quotas generates significant revenue but it also causes dependence and amounts to a sharing of distortionary rents. Be this as it may, all three options are to be preferred over the maintenance of the status quo, and therefore deserve attention.

Coherence

Summing up, through domestic reforms, possibly supported by foreign assistance, LDCs can alleviate their current supply constraints in food and agriculture. But most of them will have to go one step further and also develop agricultural exports, and for this they need better market access, especially to the EU. In this respect the lack of coherence of developed countries' policies is striking. They profess the virtues of structural adjustment and trade liberalization through the multilateral and bilateral aid channels, but maintain stern protectionism with respect to agricultural imports, and only commit themselves to reductions in export subsidies and AMS, while asking preservation of the Blue Box. Moreover, sugar stays clear of any CAP reform. It would seem that the multi-functionality approach that rewards separately all services rendered by farmers would make it easier for the EU to accept liberalization, and that with respect to sugar, a production quota reduction would be acceptable more easily than a severe cut in price. A quota reduction could also be used to mobilize aid funds, or to counter the erosion of preferences.

5.3 Access to courts

As discussed in Chapter 2, the record of the Dispute Settlement Mechanism is so far considered to be satisfactory, except in the highly politicized Banana case. Nonetheless, several suggestions for improvement were put forward recently (see South Centre, 1999a) that will be described in this section. Distinction can be made between improvements in the multilateral mechanism, and alternative court based systems.

Improvements of the multilateral procedure

Going to trial is costly, especially for developing countries. To reduce these costs, the WTO, with the assistance of the World Bank, and jointly with a selected group of countries are now organizing various support systems. The International Trade Centre in Geneva has been erected to coordinate these efforts and to provide information and training to officials from developing countries. The most recent initiative is the foundation of the ACWL (Advisory Centre on WTO Law) with resources for financial assistance in dispute settlement cases on a cost-sharing basis (ACWL, 1999).

The Dispute Settlement procedure could be made less costly by including a "DS-light." Since trading volumes of developing countries are in most cases relatively small, there is a need for a streamlined Dispute Settlement procedure for cases up to, say, one million US-dollar, with a single panelist reviewing the process and completing it within three months (as suggested by Hoekman and Mavroidis, 1999). This would meet LDC needs for a fast track procedure in small cases that nonetheless concern a large share of their total exports. Of course, far more ambitious proposals could be envisaged. One could be the development of the Appellate Body into a true WTO-court, proposed in Hudec (1998). The WTO Secretariat could be extended with the position of a special prosecutor, with the task of identifying possible violations of WTO commitments through trade policy reviews, and even the power to initiate inquiries into the legality of recorded measures, instead of only acting on complaints from member countries.

Clearly, a trial is only meaningful if the verdict is enforced eventually. So far, the GATT/WTO process has through the Dispute Settlement made the transition from consensus based to rule based decision making. Lacking is, however, a strong rule enforcement mechanism. WTO decisions are said to be binding, but they only tell who is right and who is wrong. No compensation is given to the claimant, the perpetrator has no fine to pay and can delay the implementation of the decisions by just doing something without changing the actual policy substantially. In short, to keep the dispute settlement mechanism effective it would need sanctions. It might also need an independent prosecutor. However, all these would require countries to surrender a large part of their sovereignty to a non-elected international body, and is therefore unlikely to be acceptable.

Access to national courts

The alternative would be to refer the judicial tasks to where they usually belong, that is to national courts. Whatever the direction in which it is being extended, the DSU of the WTO is only open to governments. Traders have to convince their government that their concerns are sufficiently important to warrant their attention, and eventually bring their cases to the DSU. For the trader the lobbying cost will be high but in addition, the government will often have many reasons to abstain from any action, to avoid deterioration of the relations with the country that is being accused, which will often be a donor if the exporter is a LDC. If exporters had access to the courts of the importing country they could file a case against government authorities that fail to comply with WTO regulations. They could also ask for compensation of damages, and the enforcement procedures would be simple as well. In case of joint ventures with traders or manufacturers from the developing country the situation would even be easier, since the locally based firm could take care of the legal proceedings.

The reason for this being impossible at present is that one critical legal link is still missing between WTO law and national legislation. LNV-BZ (1996) and Keyzer and Merbis (1997) propose to create the link and Hoekman and Mavroidis (1999) distinguish three possible ways of doing so. The first is for a national government to declare by law that the WTO regulation (or any other international agreement) is to have 'direct effect'. This means that private litigants are allowed to raise relevant points of WTO (international public) law before national courts. Currently, GATT rules have no direct effect in national legal order of the US and the EU.[29] A second option is to pass implementing legislation that gives private parties a basis to sue their

[29] The European Court of Justice refused to examine the compatibility of the EU's banana regime with its WTO obligations. The US Court of Appeals accepts the argument that domestic statutes prevail over GATT law. One can only agree with Tumlir (1985) who calls this a crucial weakness of the multilateral trade system.

governments for non-compliance with WTO obligations. This is also considered a far-reaching step, since once started it paves the way to other international agreements as well to become national law. The third option is to create “challenging” mechanisms. Private parties are allowed to challenge WTO inconsistent behavior by government entities before domestic courts, without saying anything on the issue of direct effect. This has happened at WTO level in the Agreement on Government Procurement (see Hoekman and Mavroidis, 1997).

It may be useful to add that the decision of granting access to domestic courts does not have to be generic. Individual countries always keep the right to refuse it. However, it can be expected that foreign investors will more easily be attracted if the country offers adequate opportunities to challenge its decisions in court. Indeed countries already compete in fields as diverse as the tax, labor, and property rights legislation. Trade legislation will join soon. Moreover, it is in the particular interest of countries that belong to a larger regional grouping such as the EU or Mercosur to take the initiative, and pass the legislation before the other members do. This will not only help them gain an edge over the other members by making their general environment more favorable for investments, but bring direct revenue as the provision of the legal services themselves is usually very attractive.

Chapter 6

New issues

Until the Uruguay round, the establishment of free markets for all internationally traded commodities was the main purpose of negotiation, hence the emphasis on tariffication of all trade related measures and subsequent reductions of these tariffs. Though this element continues to play an important role, the awareness has been growing that trade is intimately interwoven with the domestic economy and that recent technical change and transformations in the industrial organization have fundamentally changed the picture and the basic interests of the participants. In this chapter we review some of the issues.

Theoretically, the virtues of free trade are relatively clear. As argued by Johnson (1967a), whatever the reason for world prices being what they are, for a small country that has to take these as given there is no incentive to impose any tariffs, since these merely distort the price signals received by its producers and consumers at home. At the same time, if in this country consumer preferences and technologies satisfy the standard conditions, the country has no interest in imposing excise taxes on domestic production or in letting any domestic price deviate from its competitive world market level.

This raises two questions, first, what to do on the food markets, or more generally in the field of trade if the country is unable to implement the first-best policy in some sphere, and, secondly, how to deal with cases that do not meet the standard requirements. As regards the first question, underdevelopment is often characterized by market failure of various kinds. The lack of infrastructure may lead to deficiencies in procedures for product grading which results in “rough” markets that are unable to differentiate between various qualities and therefore not conducive to the supply of high quality. For several products markets may be missing altogether or highly monopolized. Furthermore, crucial government tasks commonly have to be financed largely from the proceeds of tariffs on imports or from export taxes. In the presence of such imperfections, a reduction in border protection might fail to create a welfare improvement. Finally, developing country governments often find it difficult to tax directly the profits of large multi-national and other corporations that operate within their borders and may have monopoly power on some domestic markets. In such cases tariffs and excises offer second-best alternatives.

These are typically the grounds advanced by governments in developing countries to underpin their claim for exemptions. The common reaction is that openness in trade is good for growth (e.g. Sachs and Warner, 1995, 1997), because it operates as a strong disciplining mechanism by reducing the power of local monopolists and other rent seekers, and allows importing the very services required for the improvement of grading procedures and market infrastructure. As to the argument for tariffs as an indispensable source of government revenue, a tax reform is often proposed to substitute for the loss in tariff revenue resulting from liberalization by means of direct taxation, or a tax on consumption. In short, the argument that domestic imperfections can justify protection no longer carries much weight. However, there are other cases for accepting regulation of trade, which are generally advocated on grounds of specificity, and of not meeting the standard assumptions that justify free trade. In this chapter we distinguish two groups of issues.

The first relates to regionalization. For various, partly institutional reasons, a free trade among neighboring countries within a region may offer specific advantages. The expanding membership of the EU is illustrative of this trend. Conclusion of a free trade agreement among neighboring states can be conducive to peace, and often generates economies of scale in infrastructure (transport, health, education) as well as in the diplomatic and commercial representation abroad (e.g. in Geneva or Brussels). At the same time, regional free trade agreements generally erect new barriers to trade with outsiders, causing a trade diversion which is all the more detrimental when a region consists of countries with relatively similar endowment proportions, as potential gains from trade tend to become larger when these proportions differ.

The second group of issues concerns the structural changes in the international economy due to both stronger product differentiation and higher knowledge intensity of products. Food products tend to become ever more differentiated, partly as a result of the preferences for variety on the part of richer consumers and their demand for more processed foods, partly due to their concerns about food safety and moral aspects of agricultural production (environment, animal welfare, labor standards). This weakens the position of raw material producers and creates rents on the end product that may eventually become more significant than any tariff levied on the raw material in the past. Regarding knowledge intensity, the intimate relationship between trade, foreign investment and transfer of knowledge has to be accounted for in its various ramifications. Knowledge creation has to be rewarded and requires adequate protection of intellectual property rights. Knowledge use is to a large extent non-rival ("like light, it shines on all", see World Bank 1998a), and hence cannot be managed efficiently on an unregulated free market because of free riding. Furthermore, access to knowledge no longer is the exclusive domain of education and extension agencies, since it extends beyond dissemination and increasingly requires active participation in production processes. The next sections deal with these issues in more detail.

6.1 Regionalization

Whether regionalization actually brings benefits to developing countries remains a hotly disputed subject. Regionalization often takes the institutional form of a preferential trade agreement (PTA) among neighboring countries. In some cases the PTA is little more than a barter agreement between governments but increasingly, PTAs are set up that are intended to develop into true customs unions (Mercosur, APEC, COMESA). Bhagwati (1993), Bhagwati et al. (1998) and Srinivasan (1998) view PTAs as 'stumbling blocks' to multilateral liberalization, which slow down development since they divert imports from the most efficient producers and distort the domestic specialization. On the other hand, Lawrence (1996), Frankel (1997), and Ethier (1998) view the same PTAs as 'stepping stones' towards free trade. These enable developing countries to open up for trade, at first with competitors within the same region, who often share similar cost structures and will therefore allow to pursue domestic production. Collier and Gunning (1995) argue that by their international nature PTAs tend to strengthen the commitment to policy reform and to provide a more stable and secure policy environment, which is conducive to foreign direct investments. Be this as it may, most authors agree that since in the multilateral perspective to trade liberalization, all preferences should vanish eventually, the PTAs are to be seen as no more than stepping stones and thus as transient phenomena that do not deserve elaborate institutional embedding. However, they might also become stumbling blocks because they enable the major trading blocks to keep all options open. These blocks can dismantle the PTAs if trade liberalization is a success but can always resort to managed trade in case it fails (Krugman, 1990).

REPAs under a new Lomé agreement

The current policy of the EU adds a new dimension to the debate on regionalization because the EU has decided to promote the creation of regional blocks in developing countries. Its current mandate for negotiations with ACP-countries (CEC, 1997c) specifies that the earlier set of Lomé countries should be redefined and split into regional groupings, which, however, may exist of one country only. This would seem to be at odds with the EU's stated goals (CEC, 1997a) of promoting free trade but even the current WTO-treaty allows for such arrangements, provided they are temporary and reciprocal. In fact, the EU intends to channel all its bilateral development aid to regional groupings. The regional agreements with the EU will all take the form of a Regional Economic Partnership Agreement (REPA). The REPA includes both trade, aid and cooperation aspects. Trade is regulated through an (interregional) PTA between the EU and the region concerned. Essentially the EU grants preferential tariff quotas to the countries of the region, who start liberalizing their mutual trade while establishing a rule for sharing the tariff proceeds to ensure that, say, landlocked members benefit fairly. Though the PTAs claim to define reciprocal access so as to meet WTO requirements, this access is necessarily heavily restricted by quotas (Davenport et al., 1995; Tangermann, 1997; Duponcel, 1998). Under a more free access the EU markets could become flooded with imports and the CAP would be incapacitated, or conversely the EU might dump its surpluses in the region, since the price would presumably be higher there than on the world market. Through these REPAs, the EU seeks to maintain the possibility of limiting its trade preferences exclusively to the group of ACP countries only, which conflicts in principle with the General System of Preferences.

Mercosur

Through the 1991 treaty of Asuncion, the Mercosur countries (Brazil, Argentina, Paraguay and Uruguay) went a long way in creating a customs union. They established a common external tariff and proclaimed that internal free trade should be effective by 2005. So far, some sensitive products such as sugar and automobiles are still protected by higher tariffs but the harmonization of external tariffs has been substantial (Laird, 1997), although the rates differ among sectors (Olarreaga and Soloaga, 1998).

This agreement offers a good illustration of the controversies around the issue of regionalization that would also be of relevance for Africa. Whereas in the eighties GDP growth in the Mercosur countries was a mere one per cent per annum, in the period 1991-1995 growth accelerated to 3.8 per cent, and internal trade surged. Whether this was a matter of trade diversion remains unclear. Yeats (1998) argues that external trade did not rise, but Nagarajan (1998) concludes differently, and both refer to a period before mid-1997 when at the onset of the East Asia crisis Mercosur decided to raise its external tariff on thousands of items by 25 per cent. Recently, Mercosur announced that it would again reduce its external tariff and expand its membership and international linkages. Both the US and the EU expressed their interest in association and possibly free-trade agreements with Mercosur, evidently allured by the large and strongly growing consumer markets. In practice, enlargement proves difficult to accomplish, even with neighbors at a similar stage of development. Chile has been admitted as associate member, but failed in its attempts at being upgraded to full member. Negotiations with the Andean group were unsuccessful. Deals with the US floundered and so did the attempts at far more ambitious projects such as the establishment of a free trade zone for the entire hemisphere (known as the FTAA, see Lee, 1995 and FTAA, 1999). Similarly, a deal with the EU was halted because it, quite obviously, proved incompatible with the CAP. Mercosur has large export potentials and is known to be a low cost producer for products such as cereals and beef. It is no surprise therefore, that the EU agricultural ministers eventually blocked the negotiations on a free trade deal with Chile and Mercosur (Agra-Europe, August 1997).

In sum, the basic logical problem of all PTAs is that they cannot at the same time be concluded between any large pair of trading blocks, be significant, and leave both customs unions unaffected. Therefore, regional agreements are unlikely to achieve multilateral trade liberalization via the route of PTA-interlinkage. The Mercosur experience also illustrates the vulnerability of PTAs. The agreement almost broke down when Brazil devalued its currency and Argentina increased import tariffs on Brazilian goods. African PTAs would, with their strong export orientation on raw commodities, be even more vulnerable to external shocks.

6.2 New economy related issues

6.2.1 Product differentiation: consumer concerns and vertical integration

Consumers in developed countries increasingly demand highly differentiated, processed food products, composed of ingredients that often originate from all over the world. This trend has important implications for developing countries. As these diversified products necessarily carry labels as end-product, the foreign suppliers of the ingredients do not share in the rent from product differentiation, unless they participate in the brand, and this reinforces the dominance of the final, marketing and processing parts of the chain. Product differentiation generally results from specific consumer concerns and from technological innovation.

Consumer concerns

Consumer concerns commonly relate to product safety and to moral aspects of the production process. As regards safety, the recent BSE-crisis for beef in the EU was a case in point. Changes in technology and the growing interdependence among farms (i.e. feeding ruminants with animal proteins) has allowed the mad cow disease to spread. Medical research established a link between BSE and the fatal Creutzfeldt-Jacob syndrome in humans. Government authorities established regulations whereby the feeding of animal proteins is being prohibited and every cow can be followed from stable to table. Yet, cases of fraud were detected. Consequently, supermarket chains are looking for ways to establish their own labels and product quality control, implemented through direct contracts with farmers whose feeding practices and livestock trade are being controlled very tightly. Similar developments take place in other branches of the livestock sector (e.g. in the Dutch pork industry, Den Ouden et al., 1994).

In addition, consumers have developed stronger sensitivity to moral aspects related to the mode of production. These include environmental concerns as well as the treatment of workers and animals in the production process (Barkema, 1993; Van Ravenswaay and Hoehn, 1996). The general approach so far taken by the WTO in this respect is that the WTO itself is only concerned with the physical characteristics. The WTO emphasizes that non-discrimination principles apply to all products with the same physical characteristics, independently of the mode of production.

The WTO acknowledges the importance of consumer concerns but it takes the position that the best approach for dealing with these is to let countries sign separate agreements on such matters. The WTO can contribute its long-standing experience in arriving at international trade agreements, and once the agreement has been signed the full WTO-machinery for dispute settlement might be used. But the WTO is not involved at the substantive level and, moreover, such a treaty cannot be binding on non-signatories. Product labeling can be applied to inform the consumer about the characteristics, as long as aspects pertaining to the mode of production have not been regulated through international treaties. Through labeling, national authorities can require all importers to indicate the physical content and the safety properties. Even if requirements pertaining to a description of the mode of production are banned by WTO, competition will gradually create a differentiation between labeled and unlabeled production that will reflect in prices.

Vertical integration

As consumers attribute higher priority to qualities, retailers also become more eager to offer a guarantee, which in turn requires some form of control. This leads to vertical integration. For some products, such as meat, this implies tight vertical coordination while for others, such as vintage wines, it has so far been possible to “seal” the product and “freeze” its qualities before it leaves the farm or the region of origin. The trend is also favorable for ecological farming, which relies less heavily on purchased inputs.

When international food trade becomes freer, agribusiness soon finds it profitable to outsource much of its raw material production to countries with cheap labor and ample land resources, where farmers are satisfied with lower incomes and agriculture can be less intensive. Why raise pigs in overpopulated areas of the EU where environmental costs are being charged in full, if it is possible to produce them cheaper elsewhere? Even in the absence of perfectly free trade, the preferential trade agreements of the EU would provide focus areas for the European food industry to penetrate both in terms of market outlets and outsourcing. This creates new opportunities for some developing countries. While it requires some form of vertical coordination, as all segments of the chain have to fit very tightly, full vertical integration from farm to retail is not necessarily the outcome, as the chain might consist of separate firms (Porter, 1985; Perry, 1989).

The classic image of a food market consists of farmers coming with their fresh products, pricing by grade and buyers shopping around and buying from the producer with best price-for-quality. This horizontal representation has various weaknesses of its own (Kirman, 1992). However, in a world of super-markets and franchises, the main shortcoming is presumably that it abstracts from the many transactions that must be completed along the chain until the retail level is reached. The informational requirements can become so imposing that it is impossible to fulfil them under the perfectly competitive conditions of anonymous buyers and sellers. For the buyer, the seller’s reputation becomes important, which the seller on his part will be more eager to make true in a long-standing relationship than in casual trade. In short, more vertical integration means a steady trend towards less anonymity of suppliers, more long-term contracts, and possibly joint ownership of various segments of the chain.

6.2.2 Knowledge, intellectual property rights, and imperfect competition

Besides changes in consumer preferences, the process of technological innovation itself has important structural effects on agricultural markets as well. Earlier analysis viewed this progress as a shifter that should not fundamentally change the functioning of the economy. Gradually theorists have come to acknowledge its far-reaching implications, and the topic has gained a prominent position in several branches of economics, including industrial organization, trade theory, growth theory, and contract theory. Here we can only tentatively sketch some salient phenomena and their possible implications.

Modularity, dematerialization, networks, standards

One phenomenon is occasionally referred to as modularity (Bradford, 1994; Dahlman, 1994; Reed, 1996). To save on stocks and to maintain flexibility in design, distinct suppliers increasingly produce to order components with very definite characteristics that all perfectly fit together. The major challenge in management of the whole production system is to achieve constant quality and configuration, and timely delivery of every part. Nonetheless, despite this specialization, and much like living organisms, industrial plants tend to differ less in their physical constitution than in their organization. They essentially consist of the same basic parts (control screens, robots, sensors, climate control etc.) which are only programmed differently. This greatly improves the flexibility of the capital good producing sectors, and the economies of scale they can achieve.

Another ongoing trend is known as dematerialization (Soete and ter Weel, 1999). New chip controlled equipment is made of lighter materials and much smaller than the bulky wheelworks it replaces. PC's substitute for mainframes and their air conditioned environments with sophisticated power supply. Cellular phones allow for wireless long distance connections. Developing countries typically gain from this type of change as they do from advances in medicine and bio-technology that were originally geared to serve the developed country markets, but have produced knowledge and products (e.g. seeds and vaccines) that benefit developing countries. This is the aspect "Knowledge is light" as emphasized in the 1998 World Development Report (World Bank, 1998a). Typically, the process is being characterized by high outlays on R&D, followed by low and relatively constant cost of actual manufacturing.

Thus, two opposing forces can be discerned. On the one hand, the educational requirements for using high tech devices are falling. Anyone can use a cellular phone and this makes it possible to produce these devices on a very large scale, and at low cost. On the other hand the skills to produce high tech become ever more specialized in terms of both the degree of sophistication of the new device itself and the requirement to let it meet all the industry standards. These standards reach far beyond restrictions on physical characteristics, safety, and mode of production.

In fact, setting the standard has become the name of the game (Matutes and Regibeau, 1996). This calls not only for technical skills in designing new products but also for legal dexterity, aggressiveness in marketing and shrewdness in acquisition of potential competitors. In the past any country able to produce good quality paddy or sugarcane could accede the world market and elaborate import barriers were needed to protect domestic producers. In the world of high tech, participation has become much more of a social undertaking, which requires access to networks rather than to markets. These networks have a definite packing order, and distribute privileged knowledge to their inner circle and lease less privileged information to outside customers under the protection of patents, licenses, franchises and other intellectual property rights (IPRs).

Setup costs and imperfect competition

Theorists of the industrial organization and new trade schools (e.g. Krugman, 1990) generally conclude from this that the sector is characterized by increasing returns, with the R&D expenditures as setup or fixed cost and the manufacturing costs as variable costs. In this view, the "new" economy operates in a way that is qualitatively different from that of the individual cells of the idealized competitive market where individuals and firms only communicate via prices. For theoretical research conducted in this tradition, the challenge is no longer to design general policy guidelines. It is rather to describe the intricacies of interactions among agents who decide under conditions of imperfect and unevenly distributed information (Besen and Farrell, 1994; Katz, 1986; Milgrom and Roberts, 1982; Veugelers, 1998). The approach was also welcomed in applied models, where incorporation of setup costs and markup pricing allowed to generate much stronger gains, through the increase in sales that trade liberalization allowed to achieve (DeVault, 1996; Dixit, 1984; Kielbasa and Konopielko, 1997). These gains may have contributed a great deal to the popularity of this type of model, as they provided an additional argument in favor of trade liberalization.

However, once it is accepted that economies characterized by large R&D outlays have increasing returns to scale, it becomes natural to question the virtues of perfect competition itself and hence of free trade. Indeed, if variable costs are constant and small and setup costs are high, imperfect competition is almost the only way for producers to make a profit with prices above marginal costs, through restricting output and deterring entrants. If other producers could simply copy the invention, their unrestricted entering of the market would drive the price down to the level of the direct costs, and the inventor would not recover his R&D costs and possibly socially desirable goods would not be produced. Hence, the conclusion is that imperfect competition should be tolerated and intellectual property rights protected to avoid copying. The alternative would be to cover the cost of R&D from the public budget. However, this is not a practical suggestion because the decision to engage in a particular R&D outlay is generally a discrete one. It involves large sums of money, and the central planner would find it very difficult to select profitable projects, since their impact would be so large that prices are affected. In short, by treating R&D outlays as lumpy decisions, one introduces a non-convexity that undermines decentralizability through competitive markets and may require subsidies to recover these outlays.

This raises the concern that companies might use vertical integration not only to recover their R&D costs, but also to extract monopoly rents, thereby distorting market prices. This in turn means that trade liberalization becomes questionable, since in a second best world it deprives the government of the use of tariffs to correct for the distortions caused by monopolies. Such optimal tariffs might not only be required on the market with monopoly but could permeate throughout the economy. Clearly, when taken to its extreme, treating R&D outlays as large setup costs could have devastating effects on the credibility of the entire WTO-project.

Recovering the cost of R&D

It is possible to maintain a less radical position because the setup cost approach has several important limitations. The very fact that R&D outlays precede the actual manufacturing does not mean that they should necessarily be represented as fixed costs, since in an intertemporal context all expenditures become variable. The relevant issue is whether they are “seriously” lumpy. The qualification “seriously” is needed here because lumpiness is prevalent in every production process, as machines, books or spare parts are necessarily indivisible. The critical factor is whether the indivisibility is large relative to the variations in the demand for the product. In some of the most high tech sectors it might well be the case that R&D has to reach a very high critical mass before it becomes effective, but one could argue that on global markets indivisibilities are of lesser significance. Moreover, outside the military the R&D organizations rarely engage in single product design and increasingly operate through networks of variable configuration. In sum, the empirical evidence for the production technology of knowledge being specifically lumpy is often anecdotal (FTC, 1996).

Nonetheless, even if one accepts lumpiness as a fundamental characteristic of R&D, this does not warrant the conclusion that governments should tolerate unregulated monopolies.

Through its focus on the setup cost (i.e. on the non-convexity in production) the new trade literature focuses on supply and tends to neglect the demand side of knowledge. If one accepts the view that R&D production is to be seen as a production process that is, like crop production, characterized by yield variability, and possibly non-convex input response, then excludability from the outputs of R&D becomes the real issue to be addressed. Characterizing knowledge as light, means that it acts as a non-rival input and, like for any input of this nature, the user should be charged a price equal to the marginal productivity of this input in his production process (Lindahl pricing). Free markets admittedly have a poor record in their ability to determine such prices but private firms generally have little difficulty in performing this task internally among various departments, and indeed this is one of the main reasons of their existence. The walls of the firm restore excludability, through secrecy. Patents, licenses and other IPRs can have a similar effect. Moreover, the problems of non-rivalry largely emanate from the assumed perfect jointness of the production process. In practice, the transformation to operational knowledge is expensive, since teachers, consultants and training courses have to be provided for and a market for knowledge dissemination can develop.

Yet a high R&D intensity will induce companies to form conglomerates, as size becomes a way of internalizing the excludability problem within one large firm, as opposed to a means of influencing the output price. Because this conglomerate is also engaged in using and disseminating the fruits of its R&D, possibly under decreasing returns, the set-up costs of its R&D become a smaller part of its total costs, and it might be able to operate without losses even under competitive conditions. However, the members of the conglomerate might now try to extend their cooperation in order to raise the price, but several countervailing forces can be identified. First, the product itself will usually have substitutes. Second, the firm may find it profitable to raise its profits by issuing licenses to potential entrants. This will reduce the unit profit and if the license has substitutes on the market its price will also be contained. Finally, the shareholders or customers might resist monopolistic practices if these are harmful to them. They can do so through direct pressure or by threatening the firm's reputation. If these powers fail, government and the WTO have a task to perform.

The implications are that Intellectual Property Rights are to be protected, and that vertical integration through mergers may improve social welfare if they allow for better Lindahl pricing, but that monopoly pricing is not to be tolerated (see also Keyzer and Van Wesenbeeck, 1999). At national level, this implies that strong anti-trust legislation is needed, in line with the current developments in competition policy within the EU and the US (FTC, 1996). Internationally, there is still a missing link since international competition policy is lacking (Jacquemin, 1995; Keyzer, 1998; WTO/EU, 1999). Yet, proposals for an international competition policy are being launched (Hoekman and Holmes, 1999; Scherer, 1994), while a number of countries are already concluding bilateral treaties on this subject. The implementation of international anti-trust legislation would in particular benefit developing countries that lack the resources to enforce such policy at the national level.

Chapter 7

The stakes for Ethiopia

7.1 Position of Ethiopia regarding WTO

According to Ethiopian representatives, the country's main problem with respect to its international trade is the country's *limited supply capacity*, although a lack of access to international markets is important as well. The representatives also notice that the liberalization policies of the past years were apparently unsuccessful in attracting foreign investments, presumably due to lack of infrastructure, training and institutional capacity.

Ethiopia is currently participating in the WTO as an observer, and intends to apply for full membership. It sees no large impediments to WTO membership, since it has already liberalized its economy under guidance of World Bank and IMF, and its delegation in Geneva can handle the WTO affairs. Access to the dispute settlement procedures of WTO is not considered a priority, as these procedures are considered unfavorable for LDCs, as long as they remain insignificant parties in international trade. According to the Ethiopian representatives, in the current situation, LDCs are too weak and dependent and thus lack the bargaining power to be effective in the dispute settlement procedures, for which they often also lack the legal capacity. Ethiopia fears that it will, like other least developed countries, become marginalized in world trade. Especially in Sub-Saharan Africa countries, economic growth is weak and vulnerable, and exports still depend on few commodities. The share of these countries in world trade has fallen in recent years.

To lift its supply constraints, investments are needed in the people of Ethiopia and in its economic infrastructure, which according to these representatives should preferably be financed by loans or grants from the World Bank and other international donors. Consequently, Ethiopia sees the World Bank and the IMF as its main counterparts for discussions on its economic development policy. The requirements imposed by them appear to be much stricter than the WTO rules. For example, the World Bank and IMF did not approve of a continuation of the fertilizer subsidy in Ethiopia, although WTO rules for developing countries allow this type of agricultural input subsidies for poor farmers.

Ethiopia is not eager to discuss new topics in WTO negotiations, and would rather like to see existing commitments for aid, as decided upon at WTO meetings in Marrakech and Singapore or laid down in several UN resolutions, to be implemented. This would help lift its supply constraints more than any new concept or initiative. It considers having fulfilled, through the economic reforms, all its commitments to the international community, and now awaits the community to reciprocate. Unfortunately, LDCs have so far not been able to organize any concerted effort in this respect.

Ethiopia stresses that the *Special and Differential Treatment* of the LDCs are to be viewed as an intrinsic part of WTO rules, and therefore the interests of these countries should not be treated by exceptions to general rules only. For example, the transition periods in current WTO rules for developing countries, LDCs in particular, are considered too short. They should not only be made longer but also become dependent on the initial level of economic development of the country. In the same spirit, protection of *infant industries* is considered necessary for the development of new industries in Ethiopia, such as a textiles industry or a leather goods industry.

In this respect, Ethiopia sees possibilities for irrigated cotton cultivation in arid lowland areas, which could feed to the domestic textiles industry. In its current development phase it needs protection against the stiff competition especially from Asia but even within COMESA, since it considers itself less developed than several other member countries.

Regarding the new trend of *regionalization,* Ethiopia argues that while regional cooperation might generate benefits from larger markets and economies of scale, it should be based on mutual interest between countries, and not imposed from outside. As long as countries are mainly engaged in subsistence agriculture such cooperation will bring little gains from trade. Trade requires transport infrastructure, illustrating once more that capacity constraints can dwarf all attempts at participating in the world economy. Currently, Ethiopia and Djibouti have a mutual interest in the port of Djibouti for international trade from and to Ethiopia. The regional cooperation as proposed by the EU may be applicable in Southern Africa and West Africa, but in East and Central Africa the conditions are not yet ripe. With respect to inter-regional cooperation, it is noted that if LDCs obtain duty free access to the EU in 2005 as proposed currently, other types of 'free trade' agreements with the EU become superfluous.

On the subject of *consumer concerns*, Ethiopia feels that the current phyto-sanitary measures effectively work as non-tariff barriers on exports of livestock products. Importing countries can unilaterally change their requirements to make them stricter than the prevailing international standards. For example, the current requirements of the EU on disease control are seen as excessive and far too sophisticated to be applied by Ethiopian farmers. To promote the development of livestock production in the LDCs, the phyto-sanitary measures should become more internationally standardized and LDCs should be assisted in overcoming their problems with animal diseases. Nation-wide disease control is not seen as a practical goal in the short-term for Ethiopia. A viable strategy for developing livestock production would be to start in a region that is made and kept free from disease, and from which exports could be allowed. Once the approach has proved successful in this region the area under disease control could be extended. However, in the current situation it is very hard for Ethiopia to prove that exports are from a disease free area. For the same reason, Saudi Arabia has temporarily banned imports of live animals from Ethiopia because of an outbreak of Rift Valley Fever in Kenya. Beyond the export of livestock products Ethiopia sees export opportunities for naturally produced products, to meet consumer demand in OECD countries for organic products. If it had the infrastructure, Ethiopia could for example supply organic coffee but has not started developing its own brands for export as organic food.

Finally, with respect to the issue of *intellectual property rights*, the TRIPS agreement should be applied to items like computer programs, but not to food or seeds. The world's biodiversity should be used to increase food production. Over time, Ethiopia has substantially contributed to the genetic resources held world wide, but never received any financial reward for it.

Conclusions of Addis Ababa Workshop

At an international workshop held in November 1997 in Addis Ababa (Merbis et al., 1997b) where the results of the background study for the present report were presented, representatives of Ethiopia and other African countries expressed many similar concerns. The main conclusions of the workshop were as follows.

(a) Lack of technology rather than international trade restrictions is the main problem of Sub-Saharan Africa.

(b) Domestic industry needs protection against exposure to international competition, and long transition periods were recommended for LDCs.
(c) Country specific standards on labor and environment would hamper trade, and it is recommended that international standards be developed and applied in a non-discriminatory way to imports as well as to domestic production.
(d) A lack of sufficient international competition in the seed industry is detrimental to developing countries.
(e) A loss of trade preferences would hurt LDCs.
(f) Regional cooperation is necessary to support common LDC interests in WTO negotiations.
(g) African countries need technical assistance to handle their WTO affairs.

An assessment

So far, this chapter reported on views and concerns expressed by representatives of Ethiopia and other African countries. It reflected the general position that the new issues relating to WTO were not in the interest of LDCs and should not detract attention from earlier unfulfilled aid commitments and from the more basic issues of development. No trade without roads, no productivity growth without literacy, no improvement in crop yields without good seeds, fertilizer and irrigation. In short, development efforts should concentrate on their core business rather than following every new fashion on the rich countries' market. Another way of summarizing this is simply "Don't change the subject," there is much business unfinished. Chapter 5 testified to that effect.

In our view, this is an important message that deserves attention, but it has two layers. The first is plainly that as long as the old, basic problems are not solved, it does not help to add new issues to the list. The second layer is subtler. Throughout the developed world the life cycle of products becomes ever shorter. Policy advice is no exception. Economists nowadays adapt their views very quickly, partly to keep abreast with the newest developments in their field, partly to avoid repeating themselves. This by itself is a form of dominance in the policy dialog with developing countries that are not so closely connected to the opinion leaders. Hence the second layer of "Don't change the subject" is that the countries in the North should not be given the opportunity of dictating the agenda of negotiations. This holds especially as long as they fail to fulfill earlier commitments, and much business is left unfinished, witness the protection of their agricultural and labor markets.

Nonetheless, the remainder of this chapter will be devoted to a discussion of the relevance of the issues raised in the two previous chapters. One justification is that whether or not the subject is being changed is not for any LDC to decide, or for any particular group in the North for that matter. It just seems to happen because the point is raised by some individual or simply because structural changes naturally lead to it. The topics referred to in this report as "new" issues fall in the latter category, and cannot be neglected. And yet they should not be allowed to supersede the basic concerns of LDCs in the coming WTO round.

7.2 Dealing with unfinished business

Special and differential treatment. Like Ethiopia, other LDCs will presumably want international attention to focus on supply constraints. For Ethiopia, an export oriented strategy naturally means investing in the development of water resources through irrigation, possibly with Nile water, and road construction. It requires foreign assistance to create grading systems, and joint ventures to increase the processing value and to open the marketing channels. All this will make it possible to raise crop yields, to improve the health of livestock and let it produce better quality meat and hides, and to plant fruit trees and other perennial crops. LDCs will want these subsidized investments to be intensified, without WTO interfering because of AMS provisions or limits on export subsidies. Meanwhile, development efforts cannot proceed in isolation. LDCs must look at international markets.

Access to export markets. Initial successes in rural development will eventually be dwarfed by insufficient access to export markets. Ethiopia would have to drive a very hard bargain to obtain, like Namibia, any increase in beef export quota to the EU. Its prospects of acquiring any sugar quota are bleak, unless the regime undergoes significant reform. Its fruits and vegetables can only be exported to the EU under seasonal tariffs or tight seasonal quota restrictions. The reform of the EU's Common Agricultural Policy as decided in April 1999 is mostly oriented to financial problems of the EU itself, the accession of Central and Eastern European countries in the next decade and the commitments made in the Uruguay Round Agreements. If this policy is considered as the EU's final bid in the coming WTO Millennium round, the least developed countries have little to gain from it. Obviously, the current CAP rules conflict with the proposal to give all LDCs unlimited duty free access to the EU markets, and the LDCs thus have a clear interest in further CAP reform towards free international trade in agricultural commodities. In this respect the application of the multi-functionality of agriculture within the EU, operates in their favor as it makes it easier to increase access. Yet there is a clear conflict of interests among LDCs, since those that belong to the ACP will like to see the CAP continued, and their preferential quotas extended, keeping the others out. However important agricultural development may be for the LDCs, the continuing relative decrease in the price of their agricultural export products indicates that economic development has to include industrial growth, for example by further processing of agricultural exports. For Ethiopia, the leather industry, coffee processing and the textile industry might be candidates, and for this a reduction of the tariff escalation for processed agricultural exports should become part of the WTO agenda.

Inflation. With respect to the erosion of commitments through *inflation*, developing countries should seek to maintain maximum flexibility in their Schedules with respect to the currencies they may use and the type of tariffs they invoke for notification purposes. If they became obliged to notify in domestic currency, domestic inflation would presumably impose more severe reduction requirements on AMS and export commitments than any WTO agreement ever could.

Access to courts. Finally, LDCs like Ethiopia refrain from engaging in dispute settlement procedures of WTO because they find them too complex and fear, rightly or wrongly, that their power is currently insufficient to win them. An improved access to courts, especially in Europe, would greatly help them win the confidence that, once their own supply constraints are lifted, the international community will welcome their participation in world trade.

7.3 New issues

Regionalization

Ethiopia's objective interests in regional cooperation are relatively clear. First, since the country is landlocked, it needs access to the seaports of Eritrea, Djibouti and Somalia, which can gain from handling trade to and from Ethiopia. Secondly, as main source of the Blue Nile, Ethiopia occupies a highly strategic position and downstream Sudan and Egypt definitely have an interest in friendly neighboring relations, as a possible Ethiopian decision to divert river waters for own use might seriously affect their water supply. Finally, with all neighbors, Ethiopia has an interest in containing contagious human as well as animal diseases. However, the current political situation is not favorable for reaching closer regional cooperation. In Somalia, a central government is still lacking and civil strife continues between several factions, and trade flows through Berbera port are modest. In Sudan, the civil strife in the southern part bordering Ethiopia has been lingering on for years. Currently, the relations with Eritrea are very tense due to a border conflict resulting from its recent separation from Ethiopia in 1993, and other unsettled matters relating to past debts. Consequently, trade between Ethiopia and Eritrea has come to a halt. It is fortunate that Ethiopia's relations with Djibouti remain excellent, and this city currently functions as main port. The relations with Kenya are good as well but the country lies far away and also has coffee as major export crop. Comparative advantages are therefore limited, and the long distances make it difficult to derive any economies of scope from cooperation.

Officially, Ethiopia already cooperates with all its neighbors[30] except Somalia, through the COMESA, the Common Market for Eastern and Southern Africa that aims at becoming a free trade area in November 2000. It is unlikely that this ambitious goal can be reached by then for all members, since for example Ethiopia is lagging behind in tariff reduction. It also remains unclear how cooperation among COMESA members can be reconciled with other regional cooperation agreements as envisaged by the EU. The COMESA initiative has certainly led to new trade flows among its members, but free trade is still a distant aim and Ethiopia still asks for protection of its own industry against imports from more developed industries in other member countries. Yet the COMESA market might function as stepping stone towards competitiveness on the world market and it is illustrative in this respect that Ethiopia recently imported cars assembled in Kenya, and exported assembled television sets to Zimbabwe.

A new free trade agreement with the EU, successor of the Lomé Agreement, would mean that industrial products from the EU acquire easier access to Ethiopia and other LDCs. This conflicts with LDCs wishes for prolonged protection, to build up the own industrial sector. The EU from its side wants to protect its agricultural sector, and to maintain its restrictions on imports through quotas for the main CAP commodities (wheat, beef, and sugar) included in the minimum access rules of the Uruguay Round Agreements. Under the present EU regulations, imports of fruits and vegetables from Africa are severely restricted as well. If the African LDCs want to continue protecting their domestic markets for manufacturing and services, and the EU its agricultural and labor markets, there does not seem to be much room for any bilateral 'free trade' arrangement.

Consumer concerns and product differentiation

The concerns of consumers in OECD countries with respect to food safety and modes of production concerning the environment, labor standards and animal welfare, offer new opportunities to LDCs but these can only be effectuated if their specific constraints are duly accounted for. *Consumers concerns* will stimulate government and private companies to introduce new standards and labels, which guarantee that concerns are taken seriously. So far, WTO has taken the position that standards should be established through separate international

[30] The Nile River Initiative Secretariat opened in September, 1999, in Entebbe. Through this secretariat, Ethiopia cooperates with Burundi, Democratic Republic of Congo, Egypt, Kenya, Rwanda, Sudan, Tanzania and Uganda in common pursuit of sustainable economic development and management of Nile waters. All these countries are also members of COMESA.

treaties. For each treaty the WTO has offered its dispute settlement mechanism as a vehicle to deal with conflicts in implementation. Though WTO's reluctance to extend its activities beyond its current mandate seems understandable, this approach of wait and see shifts the burden of coordination to the international forum at large. It might create a myriad of bilateral agreements, standards and labels, and hamper exports from LDCs for whom the application of the corresponding requirements is too sophisticated. One may recall in this connection that consumer concerns originally addressed themselves to the highly intensified production methods in the agricultural sector of OECD countries. It therefore seems ironic that they could eventually lead to new restrictions on exports from developing countries such as Ethiopia, where fertilizer application is low, agro-chemicals are hardly used, and livestock is raised in a natural way. Consumer concerns might generate new non-tariff barriers against trade from developing countries, just like the current phyto-sanitary standards, unless developing countries can ensure the establishment and safeguard of common basic international standards. These should satisfy the underlying consumer concerns but at the same time not be too demanding for developing countries. It is also essential that transparent and fair rules be agreed upon for assigning the burden of proof when their satisfaction is being challenged.

Obviously, a 'fair trade'-label that explicitly aims to increase welfare of specific producers in developing countries will channel benefits to its target group. Fair trade labels exist for coffee, cocoa, and bananas but as their market shares remain small, the group of beneficiaries is also very limited, and this creates a vertical product differentiation that may harm conventional producers. 'Fair' trade actually creates a specific form of vertical integration.

More generally, the trend towards vertical integration largely originates from developed countries but it has potentially important implications on the trade relations between developed and developing countries. It seems evident that the process of vertical integration causes a fundamental change in the relationship between the farmer and the agribusiness, and strengthens the hand of food importers relative to exporters, and this might be detrimental to least developed countries.

Developing countries might attempt to enter the OECD markets with their own brands and labels. They have at times been successful in this respect for fresh products such as vegetables and fruits. Easiest to maintain are labels of origin (mangoes from Mali), which obviously include some guarantee for quality as well. However, very often it will be difficult for developing countries to maintain sufficient presence and visibility on the developed countries markets for the label to be generally accepted and known. To establish the credibility of their brands and labels may require extensive advertising campaigns. A less ambitious option would be to seek alliances with established companies in OECD markets, and guarantee the required qualities through cooperation in long-term contracts or joint ventures. In such undertakings developing countries will have to fight for their share in total value added, and to avoid them becoming the raw material producer at the upstream end of the chain, as in the colonial days. The foreign company can supply technology, quality control and market access. As discussed in Chapter 6 the trend towards vertical integration might undermine the tariffication and access objectives of WTO itself, since it becomes hard to monitor the full pricing within a chain, while product differentiation automatically restricts access for unlabelled products. Here also the main challenge for LDCs is to avoid on the one hand being pushed in the segment of low priced, unlabelled products of unspecified origin, and on the other to negotiate reasonable terms with the foreign companies that offer coverage by a reputed label. For this they need market information, as well as technological and legal advice, and active trade representatives abroad to promote their interests.

To the extent that trade liberalization could increase fluctuations in farm prices, contract farming becomes a more attractive option that allows to share price as well as climatic risks among the various agents in the food chain wherever they live. The drawback of this system is that it tends to weaken the farmer's position, since his supply is inelastic in the short term and the number of processors and supermarket chains is generally small. While in the past this problem has all over the world led to the creation of farm cooperatives for processing and marketing, currently, under the pressures of competition, these cooperatives are in most countries being dismantled or converted into private corporations. Therefore, the trend towards trade liberalization and vertical integration carries with it a real danger of rural sectors turning into colonial plantations that subjugate their workers. Fortunately, if consumer awareness proves sufficient, it will be possible to implement a code of conduct that avoids excesses, since after all the issue exhibits many similarities with the question of labor standards.

In short, Ethiopia like many other LDCs may choose to focus its development efforts on the alleviation of domestic supply constraints to provide remunerative employment for its fast growing population, and not to pay much attention to upcoming concerns of rich consumers in OECD countries. But it will have to export agriculture-based goods to buy the equipment and technology necessary for its development. It will therefore have to meet quality standards and gain recognition for its products, and need international support to succeed.

Knowledge, intellectual property rights and imperfect competition

Besides product differentiation, the internalization of knowledge within the company is an important force towards vertical integration and increased scale. Developing countries face this trend and see ever fewer and larger foreign companies supplying critical inputs such as seeds for high yielding varieties, medicines or equipment for electricity plants. For LDCs like Ethiopia two aspects stand out. One is access to knowledge, the other imperfect competition.

Patents and licenses. Regarding access, the knowledge available within the vertically integrated firm is not available publicly, except and only in part through patents and licenses, for which a price has to be paid to an owner who has been given a monopoly as reward for past R&D efforts. In the absence of IPRs companies will avoid sharing any knowledge with outsiders. The trend towards vertical integration will then become stronger, and only products that cannot be duplicated will leave the R&D intensive firm. Hence, developing countries have some interest in promoting recognition of IPRs, to avoid exclusion. Yet to really be part of the action they will presumably have to acquire shares in firms rather than licenses. A problem is also that IPRs create new monopolies that need to be monitored carefully. If patents that form close substitutes come into a single hand, the owner acquires a power to extract rents. Recent development in bio-technology have led to a fast and poorly monitored expansion and accumulation of IPRs within the agro-industry, on the input side especially in relation to seeds as well as in food processing. Furthermore, it becomes important to treat IPRs in a balanced way. Developing countries may find it more difficult to organize themselves so as to establish their rights in due time. For example, the international seed industry often goes out to collect some indigenous varieties in Africa as genetic material for its breeding programs. These varieties can usually be collected on public land and therefore without any payment to the "owner" of the genetic resource. Nonetheless, once a new variety will have been developed, the farmers of the region concerned have to pay the full price for the new, patented seeds. One could argue that these farmers should share in the benefits from the patents. Similarly, inventions often benefit greatly from user feedback. Past users should share in the current proceeds of a patent. The upcoming WTO round places much emphasis on TRIPS negotiations. Developed countries generally protest that LDCs should improve their protection of IPRs, whereas LDCs generally want shorter periods of patent protection than developed countries to facilitate their engagement in product imitation. It will include further elaboration of the TRIPS agreement, which is now under evaluation (Downes and Stilwell, 1998), especially of its application in LDCs. At present, opinions seem to differ but it appears that no strong arguments can be made for international harmonization of IPRs (Deardorff, 1990; Mayer, 1998).

Imperfect competition. Next, we return to the issue of competition. Ironically, it could happen that imperfect competition on international markets favors poor countries in that it permits to maintain a system with market segmentation that enables the poor to acquire goods at lower prices they would be unable to obtain under competitive conditions. Imperfect competition does not always make the product more expensive for them, but it may, and it is clear that monopolies in the seed or the pharmaceutical industry pose a serious threat to developing countries. Whereas OECD countries have created elaborate procedures to monitor competition internally, there is very little to match these efforts at the international level. The markets within developing countries themselves are often too small to offer a niche to many competitors either in imports or domestic production. It would greatly help these developing countries if their governments or even better their companies were given the opportunity to make use of the legal institutions and procedures of the developed countries to monitor competition. In addition, a LDC could request developed countries to extend their competition laws to its territory. Companies with headquarters in the EU, and their subsidiaries, would then have to fulfill the EU requirements on competition wherever they operate, and EU competition authorities and courts could punish offenses. This approach has the advantage that it does not require any multilateral agreement, though the monitoring cost might be relatively high. It should also be noticed that imperfect competition does not always come from abroad. Indeed, domestic efforts towards vertical integration, say, between tanneries and shoe factories may be conducive to the formation of cartels which are initially successful in reaching the international market but eventually lack dynamism, innovative power or willingness to invest its profits. This will prevent them moving up the quality scale and acquiring a greater share in processing.

Knowledge creation and labor mobility. Even if patents and licenses are accessible for developing countries and adequately priced, an equally important issue for development is how to participate actively in corporate decisions on product cycles and new investments. In the knowledge intensive economy participation of qualified staff in the production process becomes as important for development as participation in the firm’s equity shares and formal negotiations between the management of foreign companies and the national government. One implication is that training of local staff becomes a global issue. It is impossible for local staff to participate fully in the company if it cannot visit headquarters and foreign branches for extended periods. Therefore, it is important for developing countries to ensure that the appropriate visa can be obtained. This issue might be dealt with under the TRIMS agreement.

Biogenetic resources. Some developing countries have a special interest in the negotiations on intellectual property rights, as they supply themselves the main biogenetic resources for development of new varieties. The Convention on Biological Diversity acknowledges benefit sharing by the countries of origin but applications of these regulations are not yet known. Furthermore, the origin of much biogenetic material available at gene banks is hard to establish, since ‘passport’ information is often missing, and this makes it hard to establish ownership.

Nonetheless, for Ethiopia the issue is of significant economic interest as it is a recognized Vavilov center of biodiversity. Through history it has contributed significantly to currently available genetic resources. Coffee is, of course, a prime example, but also some barley and sorghum varieties nowadays used in the USA were developed using genetic material from Ethiopia (ESTC, 1996). It would therefore be important for Ethiopia to see these rights recognized. However, a conflict of interest will emerge with other developing countries, if the latter also have to pay for licenses for which Ethiopia shares in the proceeds. This conflict will be less severe if the question is treated as part a general attribution of property rights over a wider range environmental resources, including the ocean and the atmosphere, because the income earned from users of these resources combined would presumably generate positive flows to all developing countries.

7.4 Conclusion

The difficulties encountered in reaching consensus on the agenda suggest that one has to be very optimistic to expect that negotiations for a new agreement on agriculture will be concluded within a year or two. One complicating factor are the presidential elections in the USA and the fact that the president of the USA lacks ‘fast track’ authority from the Congress, which makes it less attractive for other parties such as the EU to make firm commitments. Most countries are well aware of the need to avoid a situation where agriculture once more becomes a major stumbling block, if progress is to be made on other fronts.

Priority was until now given to the reduction of export subsidies and the de-coupling of producer support in developed countries. The import access for LDCs has only recently received major attention but within the domain of trade liberalization, the deeper challenges come from regionalization on the one hand and new economy issues on the other. Clearly, LDCs will be reluctant to join regional groupings that do not function because of poor administration or political tensions, or that are an impediment to trade with the rest of the world. There are no general solutions in this regard. With respect to the new economy issues, LDCs have good opportunities to join the vertical integration process so as to import knowledge, improve the quality control and grading, and produce under reputed labels. But they should be allowed to participate on their own terms. Opening up to trade and investment can be an effective means to import knowledge and to improve discipline in budgetary, monetary and various other spheres. It can also serve to increase the number of competitors and thus to promote competition on the internal market but opening up to monopolists can be dangerous, and under monopolistic competition the merits of the free trade project itself become questionable.

Indeed, developing countries might call for an international competition policy when asked to make concessions in other fields. They might also insist that free trade and competition should be looked at in their wider context. We would argue that five strongly interconnected themes can capture their main areas of interest. These are free trade, free competition, free movement of natural persons, fair assignment of property rights over environmental resources, and open access to national courts for trade related issues. While the sum of the various agenda proposals made in Seattle would indicate that all five themes will be covered in the Millennium round, the eventual lack of consensus might also imply that they will be discarded or relegated to marginal committees.

Finally, the non-governmental groups and movements who oppose the WTO process itself because they fear a loss of cultural identities may deserve more serious reply than they received until now. It may well be that their criticisms were not expressed in terms trade economists can deal with, but the fact remains that international competition necessarily causes destruction. It is precisely designed as a disciplining mechanism to keep people on the edge. Many are tired of being subjected to it or do not consider themselves ready. They fail to see how any international body that was not elected by direct voting can ever possess the authority to impose such rules. In the past, national governments have often reacted by arguing that the WTO should improve on its public relations but they have come to realize that problem is far deeper. Nonetheless, in our view these are the legitimate concerns of those who are free to choose their lifestyle and who have through their democratic channels the possibility of restricting the scope of the WTO. For the poorest of the poor living in Ethiopia, economic growth is the only way out of current misery and malnutrition, after many years of unsuccessful experiments with central planning, opening up to the market is the only alternative.

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